TAX LAW CHANGES SINCE 1987

2018

H320 - PUV Changes. (SL 2018-95)
S.L. 2018-95 creates an additional way land may be used to qualify for present-use value (PUV) taxation as wildlife conservation land. Property that qualifies for PUV taxation is appraised and taxed at its present-use value as opposed to its fair market value. S.L. 2018-95 extends the PUV classification and treatment to land that is actively and regularly used as a reserve for hunting, fishing, shooting, wildlife observation, or wildlife activities. If the land qualifies under this new provision, up to 800 acres of land can be classified for PUV taxation.
This act is effective for taxes imposed for taxable years beginning on or after July 1, 2019.

H374 - Regulatory Reform Act of 2018.
Sec. 25: Exempt Personal Property of Charter Schools from Property Tax. (SL 2018-114)
Section 25 of S.L. 2018-114 exempts the personal property of charter schools from property tax so long as the property is wholly and exclusively used for educational purposes.
This section became effective for taxes imposed for taxable years beginning on or after July 1, 2018.

H569 - Pretax Supplemental Benefits. (SL 2018-64)
S.L. 2018-64 provides that supplemental insurance plans offered to State employees through the Employee Insurance Committees may be offered on a pre-tax basis if the offering complies with Section 125 of the Internal Revenue Code.

S75 - Const. Amd. - Max. Income Tax Rate of 7.0%. (SL 2018-119)
S.L. 2018-119 proposes an amendment to the North Carolina Constitution to cap the tax rate on both personal and corporate incomes at 7% for taxable years beginning on or after January 1, 2019, and places that amendment on the ballot in the 2018 general election. The cap is currently 10%.
Except as otherwise provided, the act became effective June 28, 2018.

S99 - Appropriations Act of 2018.
Sec. 5.6: Tax Deduction for Certain Hurricane Relief Payments. (SL 2018-5)
Secs. 5.6(j) and 5.6(k) of the Appropriations Act of 2018, S.L. 2018-5, adds two tax deductions for hurricane relief payments from the State Emergency Response and Disaster Relief Reserve Fund:

- Individual taxpayers may deduct hurricane relief payments from adjusted gross income under new G.S. 105-153.5(b)(13) excluding payments for goods or services provided by the taxpayer.
- Corporate taxpayers may deduct hurricane relief payments from federal taxable income under new G.S. 105-130.5(b)(29) excluding payments for goods or services provided by the taxpayer.

The deductions are effective for taxable years beginning on or after January 1, 2017.

S99 - Appropriations Act of 2018.
Sec. 19.3: Military Affairs Commission/Members and Payment of Expenses from BRAC Funds. (SL 2018-5)
Sec. 19.3 of S.L. 2018-5 amends the laws governing expenditure of funds from the Military Presence Stabilization Fund and the voting authority of members of the General Assembly serving on the North Carolina Military Affairs Commission (NCMAC) to:

- Eliminate the restriction limiting expenditure of certain Military Presence Stabilization Funds to the 2017-2018 fiscal year.
- Require the Department of Military and Veterans Affairs (DMVA) to pay from its appropriations certain expenses approved by the NCMAC within 30 days of receiving a payment request by the NCMAC, and to make payment on any contract or grant awarded by the NCMAC no later than its due date without need of a request from the NCMAC.
- Extend to February 15, 2019, the due date of a report by the NCMAC to the Joint Legislative Oversight Committee on General Government on expenditures from the Military Presence Stabilization Fund.
- Prohibit any member of the General Assembly appointed to the NCMAC from voting on matters that expend funds appropriated by the General Assembly.

This act was vetoed by the Governor on June 6, 2018, and that veto was overridden by the General Assembly on June 12, 2018. This section became effective on July 1, 2018.

S99 - Appropriations Act of 2018.
Sec. 35.17: Require Submission of Pay Plan Design. (SL 2018-5)
Sec. 35.17 of S.L. 2018-5 requires any agency requesting an allocation from the Pay Plan Reserve of the General Fund to first submit to the Office of State Budget and Management (OSBM) a detailed description of the pay plan design, including the salary or salary range at each step within the pay plan, and the criteria for movement between steps of the pay plan.

S99 - Appropriations Act of 2018.
Sec. 35.25: State Troopers Increase/Training Loan Reimbursement. (SL 2018-5)
Sec. 35.25, as amended by Sec. 8.1 of S.L. 2018-97, implements a new pay plan for the State Highway Patrol and establishes a trooper training cost recovery program applicable after training to cadets and to certain law enforcement employers that hire cadets. To avoid possible federal income tax consequences associated with creating a forgivable loan program, Section 8.1 of the Budget Technical Corrections act (S.L. 2018-97, Senate Bill 335) restructured the program into a contract to reimburse the training expenses if the trooper separates from the Highway Patrol before 36 months of service.Instead of excusing

liability monthly under a promissory note effective during training with forgiveness over the 36-month period, a trooper will agree to reimburse the State only if they leave State employment prior to the agreed upon contract period of 36 months. Covered law enforcement employers who hire a trooper who is still under contract requirements will be liable to the State for training costs in the amount of $36,000.
The changes became effective for the 2018-2019 fiscal year.

S99 - Appropriations Act of 2018.
Sec. 37.5: Exempt DOR/IT from Transition to DIT. (SL 2018-5)
Sec. 37.5 of S.L. 2018-5, as amended by Sec. 10.4 of S.L. 2018-97, provides that the Department of Revenue is not subject to the migration of information technology functions and personnel to the Department of Information Technology. Sec. 10.4 of S.L. 2018-97 provides that the Community College System Office has until October 1, 2019, to report to the Joint Legislative Oversight Committee on Information Technology and the Fiscal Research Division on its transition plan to the Department of Information Technology.
Please see the full summary for details on the various effective dates.

CURRENT LAW: G.S. 143B-1325 requires certain State agencies to transfer information technology personnel, operations, projects, assets, and appropriate funding to the Department of Information Technology (DIT) for the State Chief Information Officer to prepare plans to transition each participating agency to DIT. S.L. 2017-204[1] provided the Department of Revenue (DOR) additional time to complete the transfer and consolidation of its information technology to DIT due to the heightened security requirements imposed by the federal government for purposes of sharing taxpayer information, which were not yet in place at DIT.

BILL ANALYSIS: Sec. 37.5 of S.L. 2018-5 provides that DOR is not subject to the migration of information technology functions and personnel to DIT. DOR's security protocols are determined by the taxpayer secrecy and confidentiality provisions of G.S. 105-259 and IRS Publication 1075. The IT personnel in DOR meet the federally-required security checks, possess IT knowledge and skill, and understand tax law and tax return processing. Although the Department will not be subject to the migration of its IT functions and personnel to DIT, it will continue to furnish tax information to the State Chief Information Officer as required by G.S. 105-259(b)(45) and G.S. 143B-1385 for use by the Government Data Analytics Center.

G.S. 143B-1325 provides that the Community College System Office, the Department of Public Instruction, DOR, and the Bipartisan State Board of Elections and Ethics Enforcement have until October 1, 2018, to report to the Joint Legislative Oversight Committee on Information Technology and the Fiscal Research Division on their respective transition plans. As DOR is no longer subject to the migration of information technology to DIT, DOR will also no longer be required to report on its transition plans. As amended, this section further provides that the Community College System Office has until October 1, 2019, to report on its transition plans.

EFFECTIVE DATE: Sec. 37.5 (c) of S.L. 2018-5 became effective July 1, 2018. The remainder of the section became effective June 12, 2018. Sec. 10.4 of S.L. 2018-97 became effective July 1, 2018.

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[1] A link to S.L. 2017-204 can be found here.

S99 - Appropriations Act of 2018.
Sec. 38.1: IRC Update. (SL 2018-5)
Sec. 38.1 of S.L. 2018-5 updates the reference to the Internal Revenue Code (IRC) from January 1, 2017, to February 9, 2018. Therefore, to the extent North Carolina follows federal tax provisions in calculating State tax liability, changes made to the IRC by the federal Tax Cuts and Jobs Act (TCJA) and the Bipartisan Budget Act of 2018 (Budget Act) will apply to North Carolina.

S99 - Appropriations Act of 2018.
Sec. 38.2: Business Tax Changes. (SL 2018-5)
Sec. 38.2 of S.L. 2018-5, as amended by Sec. 11.2(a) of S.L. 2018-97, makes various changes to the business tax statutes to make the laws more equitable, intelligible, easier to administer, and concise by eliminating unnecessary provisions.
This section has various effective dates. Please see the full summary for more detail.

CURRENT LAW, BILL ANALYSIS, AND EFFECTIVE DATE:

Except as otherwise provided, this section became effective when it became law on June 12, 2018.

Subsection	Explanation	Effective Date
(a)	Amends the definition of a "corporation" for purposes of the application of the franchise tax to include partnerships that elect to be taxed as a corporation for income tax purposes. Under current law, the definition includes limited liability companies that elect to be taxed as corporations, but it does not include partnerships. This change equalizes the treatment among all business entities that either are corporations or choose to be taxed as one. Moreover, the change makes franchise tax treatment consistent with the income tax treatment.	1/1/19, and applies to calculation of franchise tax reported on the 2018 and later returns.
(b)	Does two things as it relates to the determination of net worth for franchise tax purposes: • Eliminates vague language to make clear that if a corporation does not maintain its books in accordance with generally accepted accounting principles (GAAP), then its net worth is computed in accordance with the method it uses for federal tax purposes. If a corporation uses a method for federal tax purposes other than GAAP, then the new subdivision (1a) requires that asset valuation, depreciation, depletion, and amortization be calculated for franchise tax purposes using same method used for federal income tax purposes.	1/1/19, and applies to calculation of franchise tax reported on the 2018 and later returns.

	• Prevents a double deduction of treasury stock that is already captured in the current franchise tax calculation.	
(c)	Provides guidance to the Department with respect to the term "income-producing activity" for apportionment purposes. The modernization of the language comports with current practice and policy. Section 11.2 of S.L. 2018-97 amended this subsection to remove the clarifying language as it applies to the sourcing of intangibles for corporate income and franchise tax apportionment.[2]	
(d)	Repeals references in the corporate addback statute to credits or deductions that have expired. G.S. 105-130.47 is the film credit that expired January 1, 2015. G.S. 105-129.16H is the credit for donating funds to a nonprofit or unit of State or local government to enable the acquisition of renewable energy property, which expired January 1, 2017.	
(e), (f), and (g)	Clarifies that non-North Carolina captive insurance companies, which are those licensed and taxed in another state, are not subject to the tax on captive insurance companies, the corporate income tax, the franchise tax, or the gross premiums tax. No state taxes a foreign captive insurance company despite the fact that the insured risk may be located in the state.	
(h)	Re-enacts a provision that was inadvertently not roll-called during the 2017 Session. Section 4 of S.L. 2017-151 added massage and bodywork therapists to the list of professionals that are required to pay the annual $50 State privilege license tax. However, the bill was not roll-called at the time of enactment as required by the NC Constitution.	Applies to taxable years beginning on and after July 1, 2018.
(i)	Provides that the income tax applicable to unrelated business income of a nonprofit organization does not include amounts paid or incurred by a 501(c)(3) organization for transportation and parking benefits it	Applies to taxable years beginning or and after

[2] The original change included in this act sought to clarify that if an intangible is used in NC to generate income, such as a patent or trademark, then that income is sourced to NC. This sourcing principle is consistent with current policy as reflected in DOR bulletins. DOR suggested the clarifying language because some taxpayers have argued that if the royalty payment comes from an office located outside NC, then the income is not subject to tax in NC in spite of the fact that the patent or trademark is used in NC to generate income. However, some taxpayers feared that the change may impact the apportionment of other intangible income, such as dividends. To alleviate this concern, the Budget Technical Corrections act (Senate Bill 335, enacted as S.L. 2018-97) removed the clarifying language, thus retaining the current language.

	provides to its employees. Under the TCJA[3], a nonprofit organization that provides these benefits must pay tax on these expenses. This section ensures that NC's income tax treatment of these expenses will remain the same.	January 1, 2018

S99 - Appropriations Act of 2018.
Sec. 38.3: Federal Determinations and Amended Returns. (SL 2018-5)
Sec. 38.3 of S.L. 2018-5 makes various changes to the federal corrections statutes, which are statutes that address a taxpayer's obligation when their federal taxable income is changed or corrected at the federal level and that change affects the amount of State tax payable. Specifically, the changes create a distinction between situations where the changes are the result of an action initiated by the Internal Revenue Service (IRS) and situations where the changes are the result of an amended return voluntarily filed by a taxpayer.
This section became effective June 12, 2018, and applies to federal amended returns filed on or after that date.

S99 - Appropriations Act of 2018.
Sec. 38.4: Automatic Extension of Time to File Tax Returns. (SL 2018-5)
Sec. 38.4 of S.L. 2018-5 provides that a taxpayer who is granted an automatic extension to file a federal income tax return is granted an automatic extension to file a State income and franchise tax return.
This section applies to taxable years beginning on or after January 1, 2019.

S99 - Appropriations Act of 2018.
Sec. 38.5: Sales and Use Tax Changes. (SL 2018-5)
Sec. 38.5 of S.L. 2018-5 does the following:

- Provides an option for a retailer who pays sales and use tax on property or services, and subsequently resells them at retail, to recover the sales and use taxes the retailer originally paid.
- Extends the Sales Tax Base Expansion Protection Act for an additional year to better ensure retailers with sales tax obligations understand the applicable tax law changes.
- Clarifies the sales and use tax treatment of frequently questioned transactions.
- Streamlines, clarifies, and modernizes statutory language to comport with recent sales and use tax changes.
- Makes other miscellaneous and technical sales and use tax changes.

This section has various effective dates. Please see the full summary for more detail.

CURRENT LAW, BILL ANALYSIS, AND EFFECTIVE DATE: Sec. 38.5 of S.L. 2018-5 makes various changes to the sales and use tax laws. Unless noted otherwise, the changes became effective when they became law on June 12, 2018.

Subsection	Explanation	Effective Date

[3] The federal Tax Cut and Jobs Act. For more information, see the explanation for Section 38.1 of this act.

(a)	Clarifies that the term "mixed transaction contract" applies to real property transactions; it does not include a contract that consists of a capital improvement and repair, maintenance, and installation (RMI) services for tangible personal property.	Effective retroactively to January 1, 2017.
(b)	Makes various stylistic and clarifying changes to sales tax definitions. The following changes are of note: • In subdivision (33c), language is being added regarding certain requirements for datacenters to address the fact that often there are no jobs at the time of application for a written determination. • In subdivision (33*l*), the language that creates an exemption for security or other monitoring services from taxable RMI services is being moved to the exemption statute {See subsection (j)}. The changes in this subdivision also separate services applicable to motor vehicles into one sub-subdivision. • In subdivision (37), the language clarifies that a credit allowed for a trade-in does not reduce the sales price of the item purchased. • In subdivision (45a), the reference date to the Streamlined Agreement is updated to the most recent iteration. • In subdivision (49), a reference in the definition of "use" is being deleted because it is no longer applicable on or after January 1, 2017, as a result of the change to the definition of "storage" for sales and purchases.	
(c)	Merges the imposition of sales and use tax of RMI services with the taxation of the items themselves. This change alleviates the necessity of determining whether the imposition is on the sale of the item plus installation or on the RMI service. The taxation of the installation is the same, regardless of how it is classified; and this change removes any distinction that may exist.	
(d)	Does two things in the sourcing statute: • Clarifies that the sourcing principles are generally for the benefit of the seller and that they do not alter the imposition of the use tax against a purchaser.	

	• Provides guidance regarding the sourcing of computer software renewal. Currently, the statute is silent on this issue and the new language is consistent with the provisions of the Streamlined Sales and Use Tax Agreement.	
(e)	Clarifies that certain activities are exempt from the sales and use tax on admission charges. The Department receives a number of inquiries regarding whether certain charges are subject to or exempt from the tax on admissions charges. Much of the administration of the tax hinges on the definition of "admission charges" which states, in part, "gross receipts derived for the right to attend an entertainment activity." The exemption for these activities is consistent with current practice, but by listing them explicitly in the statute, it will provide clearer guidance to taxpayers.	
(f)	Moves service contract exemptions from the service contract statute to the sales tax exemption statute. It is not a substantive change {See subsection (j)}.	
(g)	Corrects a statutory cross-reference.	Effective retroactively to January 1, 2017.
(h) and (i)	Provides a mechanism for a retailer who pays sales and use tax on property or services and subsequently resells the property or service at retail to recover the sales tax originally paid to a seller. The retailer could recover the sales tax originally paid by reducing taxable receipts by the taxable amount of the purchase price of the property or services resold for the period in which the retail sales occurs.[4] The records of the retailer must clearly reflect and support the adjustment to taxable receipts for the period in which the adjustment is made. The General Assembly provided a temporary means for a retailer to recover sales and use tax originally paid on an item subsequently resold at retail last session in section 2.8 of S.L. 2017-204, and directed the Revenue Laws Study Committee to study the feasibility of providing a permanent means.	

[4] A retailer who purchases property or services for resell may purchase the items with a sales tax exemption certificate. If the items are subsequently used by the retailer, as opposed to resold, the retailer must remit use tax on the items purchased. The mechanism provided by this section give the retailer a different way to address this situation.

(j)	Makes various technical and clarifying changes to the sales and use tax exemption statute. The notable changes are as follow: • Last year, the General Assembly repealed the 1%/$80 privilege tax on mill machinery and substituted a sales tax exemption. The intent was to keep the interpretation and application of Article 5F the same, but to eliminate the tax on those items. Under the prior law, G.S. 105-187.51 specified that the term "accessories" did not include electricity. This caveat was inadvertently dropped when the language was moved into the sales tax exemption statute. The change in subdivision (5e) corrects the omission. • Subdivision (13) clarifies the taxation of over-the-counter drugs. In 2003, NC changed its taxation of drugs to use the defined terms under the Streamlined Sales and Use Tax Agreement. Since that time, drugs required by federal law to be dispensed only on prescription and over-the-counter drugs sold on prescription have been exempt from sales tax and the Department's Directives have provided guidance that adheres to the statutory exemptions. However, several questions continue to arise in this area and the intent of the amendment to this subdivision is to clarify the statutory language and adhere to the historical application. The amendment makes it clear that pet food is subject to tax, even if the manufacturer of that food requires that the food be sold on prescription; the exemption only applies to drugs required by *federal law* to be dispensed only on prescription. The amendment also makes it clear that over-the-counter drugs used to treat a patient in a medical facility are subject to tax; the exemption only applies to over-the-counter drugs *sold* on prescription. • Subdivision (15) provides guidance with respect to "worthless accounts" by reference to "bad debts" under the Code. A retailer may deduct worthless accounts from gross sales.	

	• Relocates the current exemptions from the tax on RMI services and service contracts from the service contract statute. • Subdivision (70) is not a substantive change but merely corresponds with and cross-references the statute that sets out how to administer the tax on accommodations. That statute currently provides exemptions for private residences rented for fewer than 15 days a year, an accommodation provided for 90 or more days, and accommodations provided by a school, camp, or similar entity where a fee is charged for enrollment.	
(k)	This subsection does two things: • Clarifies that a qualifying farmer may be a person who boards horses. This clarification conforms to a similar change made to the present use value statutes last session. • Provides that remedies, vaccines, medications, litter materials, feeds, rodenticides, insecticides, and other substances may be exempt from sales and use tax if purchased for use on animals and plants held or produced for commercial purposes by a qualifying farmer. Prior to the tax law change made in 2014, these substances were exempt from tax if purchased for use on animals or plants held or produced for commercial purposes. Effective July 1, 2014, these substances *had to be purchased by a qualifying farmer* to meet the exemption requirements. Under the change made by this section, the exemption applies regardless of who purchases the substances so long as the substances are used to provide a service to a person who holds a qualifying farmer exemption certificate or a conditional farmer exemption certificate. Provides a person who paid sales and use tax for a return period ending prior to the date this subsection became law on an item exempt under this subsection may seek a refund directly from the Department of Revenue. The request must be made on or before October 1, 2018.	Effective retroactively to July 1, 2014.
(*l*)	Adds the term "taxable" to the statute authorizing a sales tax refund on certain purchases by an interstate carrier. By adding this term, it will identify that motor	

	vehicle service contracts are exempt from sales and use taxes and will eliminate the requirement to include purchases of various items that are exempt from sales and use tax. Since the refund is calculated using a ratio reflecting in-State mileage which is then multiplied by the purchase price of the items purchased, the refund amount is more accurately reflective of the formula if only taxable items are included within the total purchase price of items.	
(m)	Makes a technical change to accurately correspond with defined term.	
(n)	Eliminates a provision limiting the Secretary to extend the time for filing a sales tax return to no more than 30 days after the regular due date of the return. This change came about as the result of needing to extend the time beyond the 30-day period for taxpayers who were affected by Hurricane Matthew. With the change, sales tax extensions would be governed by G.S. 105-263 without the 30-day limitation. Under that statute, an extension of time for filing a return other than a franchise tax return or an income tax return extends the time for paying the tax due and the time when the penalty attaches for failure to pay the tax. However, interest accrues on the tax due from the original due date of the return.	
(o)	Makes two changes in the direct pay permit statute: • Clarifies that a direct pay permit is not applicable to any of the items that are subject to the combined general rate of tax, with the exception of telecommunication service as allowed under G.S. 105-164.27A(b). • Clarifies that items withdrawn from inventory and sent to another state are subject to tax in NC because the first "use" occurs in this State. This change is consistent with removal of the exceptions from the definition of "storage," effective January 1, 2017.	
(p)	Adds facilitators to the statute that authorizes the Secretary to estimate tax due and assess entities with sales tax remittance obligations when those entities fail to file a return or file a false or fraudulent return. They are being added because facilitators have sales tax remittance obligations under the sales tax statutes along with retailers and wholesale merchants.	

(q)	Extends the Sales Tax Base Expansion Protection Act for an additional year to better ensure retailers with sales tax obligations understand the applicable tax law changes. Under the Act, impacted retailers are given a grace period under which the Department will not impose assessments if the retailer demonstrates a good faith effort to comply. It also adds transactions to the grace period that have been inadvertently omitted.	
(r)	Corrects a cross-reference due to the repeal of a subsection.	
(s)	Makes a grammatical change.	
(t)	Provides that a consumer must keep records of items purchased inside the State, as well as outside the State. This change is needed to enable the Department to administer the new provision enacted by subsection (h) of this section that allows a retailer who pays sales and use tax on property or services and subsequently resells the property or service at retail to recover the sales tax originally paid to a seller. It also highlights for the retailer the need to retain these records.	
(u)	Provides a sale tax exemption for that portion of the gross receipts derived from an admission charge that is described in section 170(*l*)(2) of the Code. Under the federal Tax Cuts and Jobs Act, a charitable deduction is no longer allowed for an amount paid to an educational institution of higher learning if the taxpayer receives, directly or indirectly, the right to purchase tickets for an athletic event. Under sales tax law, any amount deductible as a charitable contribution is exempt from sales tax. The amendment ensures that any change in the deductibility of a contribution for income tax purposes does not inadvertently broaden the sales tax base for admission charges.	
(v)	Modernizes the statute to recognize the expansion of the sales tax base to services.	
(w)	Modernizes the statute and makes changes consistent with provisions in Part VI of the act that provide a framework for the Department of Revenue to offer and prescribe the format for electronic filings.	
(x), (y), and (z)	Defines a property management contract and provides that a property management contract is not subject to sales tax. The effective date is January 1, 2020. The service of providing property management is not currently subject to sales tax. However, RMI	Effective January 1, 2020

	services that a property management company may perform in addition to its management services may be subject to sales tax. Directs the Revenue Laws Study Committee to review the amendments made by subsections (x) and (y), and to recommend any changes necessary to make the law concise, intelligible, easy to administer, and equitable.	

S99 - Appropriations Act of 2018.
Sec. 38.6: Excise Tax Changes. (SL 2018-5)
Sec. 38.6 of S.L. 2018-5 makes various excise tax changes, including the following:

- Requiring certain ABC permit holders to register with the Department of Revenue (Department) in order to aid in tax compliance.
- Increasing the motor fuel rate authorized to be charged by a certain class of gas stations allowed to charge the South Carolina rate due to the gas station being considered in North Carolina because of the NC/SC border recertification in 2016. The rate increase will be 2Â¢ each year over the next six years, totaling 12Â¢, to mirror the motor fuel rate increase imposed in South Carolina.

Sec. 38.6(c), requiring certain listed ABC permit holders to register with the Department and to notify the Department when a permittee discontinues their business, becomes effective July 1, 2018.
Except as otherwise provided, this section became effective June 12, 2018.

S99 - Appropriations Act of 2018.
Sec. 38.7: Modified Risk Tobacco Product Tax Reduction. (SL 2018-5)
Sec. 38.7 of S.L. 2018-5 provides an excise tax rate reduction for modified risk tobacco products. A modified risk tobacco product is a product that is sold or distributed for use to reduce harm or the risk of tobacco-related disease associated with commercially-marketed tobacco products. For a product to qualify as a modified risk tobacco product, it must be issued an order by the United States Food and Drug Administration (FDA). To date, the FDA has not issued any such orders.
This section became effective June 12, 2018.

S99 - Appropriations Act of 2018.
Sec. 38.8: Allow Cities to Use Revenues for Public Education. (SL 2018-5)
Sec. 38.8 of S.L. 2018-5, as amended by Sec. 11.1 of S.L. 2018-97, authorizes, but does not require, cities to levy property taxes to supplement funding for elementary and secondary public education that benefits the residents of the city and to appropriate those revenues, in addition to any other unrestricted revenues,for that purpose.
This section became effective July 1, 2018, and applies to revenues derived from taxes levied on or after that date.

S99 - Appropriations Act of 2018.
Sec. 38.9: Waive Certain Property Tax Penalties and Interest. (SL 2018-5)
Sec. 38.9 of S.L. 2018-5, as amended by Sec. 9.5 of S.L. 2018-76, provides an additional circumstance under which certain property tax deadlines are extended to the next business day. The additional circumstance is when all of the following conditions occur on the due date: (i) the tax office is closed, (ii) the U.S. Postal Service did not provide service to the taxpayer's address, and (iii) a disaster has been declared.
This section is effective for taxes imposed for taxable years beginning on or after July 1, 2017.

S99 - Appropriations Act of 2018.
Sec. 38.10: Other Tax Changes. (SL 2018-5)
Sec. 38.10 of S.L. 2018-5 makes several miscellaneous tax changes, including the following:

- Clarifies that when a corporation's articles of incorporation or a limited liability company's articles of organization are suspended, the entity is nevertheless liable for its tax obligations.
- Provides that meals other than breakfast served at a bed and breakfast home or inn must be separately stated rather than added to the room rate. The change more accurately reflects the intended result when the General Assembly changed the law in 2017 to allow bed and breakfast inns to serve lunch and dinner. The effect of this change means that those meals will be subject to State and local sales tax and the prepared food tax, if there is one, but not the occupancy tax.
- Repeals a provision enacted last year that inadvertently created a double tax benefit for funds placed in a Personal Education Savings Account. The deduction will remain in place, but the exclusion from income is repealed. This provision is effective for taxable years beginning on or after January 1, 2018.
- Authorizes the Secretary of Revenue (Secretary) to make provisions for the electronic filing of returns and modifies the penalties related to informational returns in an effort to combat refund fraud and identity theft.

This section has various effective dates. Please see the full summary for more detail.

CURRENT LAW, BILL ANALYSIS, AND EFFECTIVE DATE:

Subsection	Explanation	Effective Date
(a) and (b)	Clarifies that the imposition of a revenue suspension, which is an act done by the Secretary of State at the direction of the Department of Revenue (Department), does not mean that the suspended corporation or LLC ceases to be liable following the suspension for accrued, current, or subsequent State taxes; rather the tax liability remains unaffected by the suspension.	June 12, 2018
(c)	Clarifies the expiration date of a provision that allows the Secretary to compromise the liability of a retailer who is assessed for failure to properly collect sales	June 12, 2018

	tax on admission charges, service contracts, prepaid meal plans, or aviation gasoline and jet fuel. The language is being adjusted to mirror the language in G.S. 105-237.1(a)(7) because the intent was for the provision to be tied to a certain reporting period and not for the expiration to be tied to when assessments are issued.	
(d)	Adds references to recently created property tax exemptions to the list of those for which a property owner must file a single application. Generally speaking, a property owner seeking a property tax exemption must file an annual application. There are some exceptions, under which either no application is required or only a one-time application is required. This section adds the following exemptions to the single application requirement; these exemptions were established in recent years but corresponding changes were not made to the application statute: • Real and personal property occupied by charter schools that is wholly and exclusively used for educational purposes. • Energy mineral interest in property for which a permit has not been issued under G.S. 113-395. • Real and personal property located on lands held in trust by the United State for the Eastern Band of Cherokee Indians, regardless of ownership. • A mobile classroom or modular unit that is occupied by a school and used exclusively for educational purposes.	June 12, 2018
(e) and (f)	Corrects a cross-reference.	June 12, 2018
(g)	Requires that lunch and dinner meals, served at the option of guests staying at a bed and breakfast home or inn, be charged separately on the guest's bill and, therefore, are not included in the room rate. This change corrects a provision enacted last year to more accurately reflect the General Assembly's intent. The effect of this change means that those meals will be subject to State and local sales tax and the prepared food tax, if there is one, but not the occupancy tax. This treatment is consistent with how traditional room service meals are taxed at hotels. By contrast, the room rental and the breakfast, which is typically included as part of the room rental, is subject to State and local sales tax and occupancy tax.	Effective July 1, 2018, and applies to gross receipts derived from the rental of an accommodation that a consumer occupies or has a right to occupy on or after that date.

	Subsection 38.10(s), the effective date provisions for this section, provide that a retailer is not liable for an undercollection of sales tax, occupancy tax, or prepared food and beverage tax if the retailer made a good-faith effort to comply with the law and collect the proper amount of tax; this provision applies only to the period beginning January 1, 2018, and ending July 1, 2018.	
(h)	Waives an antiquated restriction regarding sales and use tax revenue distributed to a municipality for water and sewer capital outlay purposes. G.S. 105-487(b) required a municipality to use a percentage of the sales and use tax revenue distributed to it under Article 40 of Chapter 105 of the General Statutes, First One-Half Cent (½¢) Local Government Sales and Use Tax, only for water and sewage capital outlay purposes. This restriction was time-limited. Prior to the sunset of the restriction, a municipality could petition the Local Government Commission to waive part or all of the restriction if the municipality demonstrated that its water and sewer needs could be met without the use of the restricted sales tax revenue. A similar restriction existed under Article 42, Second One-Half Cent (½¢) Local Government Sales and Use Tax. The restrictions on this use expired more than 20 years ago. The General Assembly repealed the obsolete restrictions in S.L. 1998-98: G.S. 105-487(b) and G.S. 105-504. Some municipalities have monies in their enterprise funds received from sales and use tax distributions prior to the expiration of the restrictions. Those funds must be expended as provided in the statute that existed at the time of the distributions, unless the municipality petitions the Local Government Commission to waive the restriction and the petition is approved. Under 20-NCAC 03.0112, the Local Government Commission charges a fee of $625.00 for services rendered to obtain this approval. There are some municipalities who do not own or operate a water or sewer system. In at least once instance, the amount of revenue subject to the restriction is less than $1,500. This section would allow a municipality that does not own or operate a water or sewer system to expend those funds for any public purpose without the necessity of petitioning the Local Government Commission for approval.	June 12, 2018
(i)	Repeals an obsolete provision.	June 12, 2018

(j) and (k)	Provides more specificity with regard to the expiration of the Historic Rehabilitation Tax Credits. The State historic tax credit under Article 3D expired for expenditures incurred on or after January 1, 2015. However, the taxable year for which the credit is taken is not the year in which the expenditures are incurred, but the taxable year in which the certified historic structure is placed in service. Generally speaking, "placed in service" is the earlier of the taxable year in which the period for depreciation with respect to the property begins, or the taxable year in which the property is available for a specifically assigned function (ie, trade or business, production of income, personal activity, tax-exempt activity). The purpose of these subsections is to give more specificity with regard to the expiration of the tax credit, so the Department will know with certainty when it may remove the tax credit from the tax forms. Under subsection (j), the property for which an expenditure was incurred prior to January 1, 2015, must be placed in service by January 1, 2023. Subsection (k) makes a similar clarification to the prospective sunset of the existing historic rehabilitation tax credit under Article 3L – the credit expires for expenditures incurred on or after January 1, 2020, and the historic structure for which those expenses were incurred must be placed in service by January 1, 2028.	June 12, 2018
(*l*)	Deletes a reference to an expired credit that is not permitted to be claimed by an estate or trust. G.S. 105-153.10 is the child credit that is repealed for tax years beginning on or after January 1, 2018.	June 12, 2018
(m)	Repeals a provision that creates a double income tax benefit for funds in a Personal Education Savings Account (PESA). A PESA is a bank account provided to a parent for the purpose of holding scholarship funds awarded by the State Education Assistance Authority for an eligible student to be used for certain qualifying education expenses. The General Assembly enacted the program in Section 10A.4 of S.L. 2017-57. As part of the program's provisions, it provides that funds deposited in a PESA are not taxable income. In addition, the legislation provided an income tax deduction from adjusted gross income for amounts	For taxable years beginning on or after January 1, 2018.

	deposited in a PESA, to the extent those funds are included in adjusted gross income. To prevent a double tax deduction, this subsection removes the language from the PESA statute stating that funds deposited into a PESA are not taxable income, and leaves the applicable deduction in the tax statutes.	
(n)	Restores the "out of business" provision, which directs employers as to when they must file the withholding reconciliation informational return if the employer terminates its business during the calendar year. In 2015, the General Assembly changed the due date for filing the NC-3 Form from "the same date the employer's federal information return of federal income taxes withheld from wages is due under the Code" to "January 31." Under the Code, an employer that goes out of business is required to file the federal reconciliation report with the IRS within 30 days from the last day the taxpayer has payroll. An unintended consequence of changing the due date without reference to the Code was the loss of this 30- day provision. This change restores that requirement for NC tax purposes. This section also moves existing language from another statute into this statute. This language is not new but is being relocated. (See summary for subsection (p) of this section).	June 12, 2018
(o)	Corrects a typographical error and strikes penalty language for failure to timely file an information request because the penalty language is being modified and addressed in another statute. (See summary of Section 38.10(p)).	June 12, 2018
(p)	Modifies the existing penalty for failure to file an informational return and creates a $200.00 penalty for failure to file an informational return in the proper format. The current penalty for failure to file an NC-3 is $50.00; the current penalty for failure to file an informational return under G.S. 105-251.2, which applies to occupational licensing boards, alcohol vendors, and payment settlement entities, is $1,000. This subsection tries to better align these penalties by changing both to $50.00 per day with a maximum penalty of $1,000. This issue was studied by the Revenue Laws Study Committee during the 2017-2018 interim and links to	June 12, 2018

	the Department and staff presentations can be found here and here.	
(q)	Provides that the Secretary will prescribe when a return, report, payment, or any other document that is electronically submitted to the Department is considered timely filed.	June 12, 2018
(r)	Provides a framework for the Department to offer and prescribe the format for electronic filings. This statute includes authority to waive an electronic submission requirement and requires the Department to publish annually on its website a list of returns that are *required* to be filed electronically and those that are *permitted* to be filed electronically during the next calendar year.	June 12, 2018

S220 - Motor Fuel Tax Exemption for Joint Agency. (SL 2018-39)
S.L. 2018-39 exempts a joint agency created by interlocal agreement for the purposes of fire protection, police protection, or emergency services from having to pay motor fuel excise taxes.
This act becomes effective October 1, 2018, and applies to purchases made on or after that date.

S411 - Various Motor Vehicle Law Revisions.
Secs. 6, 7, and 8: Motor Vehicle Taxes. (SL 2018-42)
Secs. 6, 7, and 8 of S.L. 2018-42 clarify the applicability of local and regional public transportation registration taxes and DMV fee adjustments on motor vehicles sold by a motor vehicle dealer by making clear that the applicable rate or fee is the one in effect on the date of sale, regardless of the date of submission of the title and registration application.
These sections became effective June 22, 2018, and apply to any tax or tax increase with an effective date on or after that date.

S412 - Abandoned Vehicles/Charities. (SL 2018-43)
S.L. 2018-43 does the following:

- Provides a process for used motor vehicle dealers to sell vehicles donated to charitable organizations when the donated vehicle is titled in this State but the title is not provided with the donation.
- Provides that a charitable organization is not required to register and title a vehicle that was donated to the organization solely for purposes of resale.
- Provides that willful and intentional failure to comply with the new statutory process is grounds for denying, suspending, placing on probation, or revoking a motor vehicle dealer's license.
- Exempts a charitable organization where a vehicle was donated to the organization solely for purposes of resale from the definition of motor vehicle dealer.

- Exempts a charitable organization from paying highway use tax for a title issued as the result of a transfer of a vehicle to the organization that was donated solely for purposes of resale.

This act became effective June 22, 2018.

S561 - Violate Tax Law/Venue/Property Tax. (SL 2018-98)
S.L. 2018-98 does the following:

- Exempts from property tax leasehold interests in exempt property. This change is effective for taxes imposed for taxable years beginning on or after July 1, 2019.
- Changes the venue for the prosecution of criminal tax violations from Raleigh to the county where the charged offense occurs. This change becomes effective December 1, 2018, and applies to offenses committed on or after that date.

S616 - Heroin & Opioid Prevention & Enforcement Act. (SL 2018-44)
S.L. 2018-44 does the following:

- Amends laws pertaining to the North Carolina Controlled Substances Act.
- Amends laws pertaining to the North Carolina Controlled Substances Reporting System Act.
- Establishes conditions and requirements for the release of information from the Controlled Substances Reporting System to local law enforcement.
- Revises and establishes penalties for certain violations.
- Expresses the intent to appropriate additional funds in the future for community-based substance use disorder treatment and recovery services, the purchase of overdose medications, Operation Medicine Drop, and a special agent position with the State Bureau of Investigation.
- Amends the statewide Telepsychiatry program that delivers mental health and substance abuse care.

This act has various effective dates. Please see the full summary for more detail.

BILL ANALYSIS:

Part I. TITLE OF ACT

Section 1 sets forth the title of the act as the Heroin and Opioid Prevention and Enforcement (HOPE) Act of 2018.

Part II. AMENDMENTS TO THE NORTH CAROLINA CONTROLLED SUBSTANCES ACT

Sections 2, 3, and 6 make technical changes to the chemical names of two controlled substances.

Section 4 includes the immediate precursor chemical required for the manufacture of fentanyl as a Schedule II Controlled Substance under G.S. 90-90.

Section 5 adds the precursor chemical used in the manufacturing process of fentanyl to the list of immediate precursor chemicals.

Section 7 makes conforming changes to the way opioids are referenced in Chapter 90, expands the criminal offenses related to MDPV to include "any substituted cathinone" and consolidates the existing offenses in light of the expansion.

Section 8 adds a new section to Article 5 of Chapter 90 of the General Statutes that does the following:

- Creates the position of a "certified diversion investigator".
- Requires that a certified diversion investigator request and receive prescription information from pharmacies when required, and only when required, for an active investigation related to a controlled substance.
- Requires that a pharmacy provide the requested information, and protects the pharmacist from liability for sharing the confidential information.

Section 9 makes technical corrections, expands the Class 1 misdemeanor for aiding the diversion of a controlled substance and creates the following criminal offenses:

- A Class G felony for intentionally aiding the diversion of a controlled substance.
- A Class E felony for a medical professional that intentionally dilutes or substitutes any controlled substance.

Part III. AMENDMENTS PERTAINING TO THE NORTH CAROLINA CONTROLLED SUBSTANCES REPORTING SYSTEM ACT

The Controlled Substances Reporting System (CSRS) is a database maintained by DHHS that tracks prescriptions for Schedule II through Schedule V controlled substances. Dispensers are required to report certain information on prescriptions they fill within close of the next business day after the prescription is delivered, but are encouraged to report such information within 24 hours of delivery. Such information is confidential and may only be accessed by certain persons for specific purposes set forth by statute. Current law allows DHHS to release CSRS data to persons authorized to prescribe controlled substances, special agents of the North Carolina SBI, as well as others.

Section 10 requires a lawful controlled substance dispenser to report the prescriber's national provider identification number, and relieves a pharmacy or pharmacist from liability for failure to report a prescriber's national identification number when it is not received by the pharmacy.

Section 11(a) authorizes access to the controlled substance reporting system to the Attorney General of North Carolina, expands access to the Tactical Diversion Squad in North Carolina, and creates the following criminal offenses:

- A Class I felony for accessing unauthorized prescription information in the CSRS.
- A Class I felony for disclosing prescription information for an unauthorized purpose.
- A Class H felony for maliciously obtaining, disclosing, or disseminating prescription information for personal gain or to cause harm.

Section 11(a) also does the following:

- Permanently bars an individual convicted of one of these criminal offenses from accessing the CSRS.
- Expands the SBI's Diversion & Environmental Crimes Unit's jurisdiction to include suspected criminal use of the CSRS.

Section 11(b) establishes the following conditions and requirements for the release of information from the CSRS to local law enforcement:

- Release is only authorized to a certified diversion investigator, working with a qualified law enforcement agency, related to illegal controlled substance activity, and the request for information has been approved by the SBI.
- The SBI is not liable for the disclosure of confidential information as requested by the certified diversion investigator.
- Documentation of the requested information and resulting investigations will be kept, and audited by the SBI.
- The information obtained by the certified diversion investigator may only be shared with law enforcement and prosecutors directly involved with the investigation and prosecution.
- The matter may be referred by local law enforcement to the SBI if appropriate.
- Information may not be requested or received from other states, using the CSRS.
- Defines the new terms related to the parties authorized access to the reporting system.
- The Department of Health and Human Services (DHHS) is directed to enable specific access to the CSRS.
- Direct DHHS to document the system's activity so that unauthorized access may be investigated by the SBI and prosecuted by the Office of the Attorney General.

Section 11(c) directs DHHS to begin developing ways to implement the data release provisions required.

Section 12 enables DHHS to temporarily suspend a reporting system user's access to the system in the event of a suspected unauthorized use of information, and relieves a party acting lawfully and in good faith from liability for accessing and disclosing confidential information.

Section 13 authorizes and describes the training and certification of diversion investigators.

Section 14 creates the minimum standards and levels of training for diversion investigators and diversion supervisors, and requires recertification at least every three years, and authorizes Training and Standards Commission to suspend, revoke, and deny certification.

Part IV. APPROPRIATIONS

Section 15 expresses the General Assembly's intent to appropriate additional funds in the future for community-based substance use disorder treatment and recovery services, the purchase of overdose medications, Operation Medicine Drop, and a special agent position within the SBI.

Part IV-A. TELEPSYCHIATRY

Section 15.1 adds new definitions and modifies existing definitions of G.S. 143B-139.4B, which requires the Office of Rural Health to oversee and monitor establishment and administration of a statewide telepsychiatry program. This section creates a definition for community-based site. This section modifies the definition for referring site to include approved community-based sites, and removes the word acute from the definitions of consultant site, consulting provider and telepsychiatry.

Section 15.1 also requires referring sites to use consulting providers at a consultant site to provide timely psychiatric assessment and rapid initiation of treatment for patients at the referring emergency department site experiencing mental health or substance abuse or for patients at an approved community-based site in need of mental health or substance abuse care.

Part V. SEVERABILITY CLAUSE AND EFFECTIVE DATE

Section 16 makes any provisions of the bill held to be invalid by a court severable from the other provisions of the bill, which would remain in effect.

Section 17. The section requiring a lawful controlled substance dispenser to report the prescriber's national provider identification number, and relieving a pharmacy or pharmacist from liability for failure to report a prescriber's national identification number becomes effective September 1, 2018.

The criminal offenses expanded and created by this act become effective December 1, 2018.

The sections making technical changes to the North Carolina Controlled Substances Act, including the immediate precursor chemical required for the manufacture of fentanyl as a Schedule II Controlled Substance and adding the precursor chemical used in the manufacturing process of fentanyl to the list of immediate precursor chemicals become effective December 1, 2018.

The section creating the position of a certified diversion investigator, requiring a certified diversion investigator to request and receive information from pharmacies for an active investigation related to a controlled substance and requiring a pharmacy to provide the requested information becomes effective July 1, 2019.

The section establishing the conditions and requirements for the release of information from the CSRS to local law enforcement becomes effective July 1, 2019.

The remainder of this act became effective July 1, 2018.

Jennifer Bedford contributed substantially to the preparation of this summary.

S711 - NC Farm Act of 2018.
Sec. 14: Provide Uniformity to Assessment of Farm Machinery. (SL 2018-113)
Sec. 14 of S.L. 2018-113 directs the Department of Revenue to publish a depreciation schedule for farm equipment and make the schedule electronically available on its website. A county appraiser may use any of the appraisal methods provided in statute and must consider relevant taxpayer information. However, if the county uses a cost approach method to appraise the equipment, the county must appraise the equipment using the depreciation schedule published by the Department of Revenue.
This bill was vetoed by the Governor on June 25, 2018, and that veto was overridden by the General Assembly on June 27, 2018. This section is effective for taxes imposed for taxable years beginning on or after July 1, 2019.

S711 - NC Farm Act of 2018.
Sec. 15: Clarify Cemetery Property Tax Exemption. (SL 2018-113)
Under existing law, real property set apart for burial purposes, where the property is not offered for sale or rental or sale of burial rights therein, is not subject to property tax. Sec.

15 of S.L. 2018-113 provides that the owner of the property is not required to apply for the property tax exemption for burial property. A county is prohibited from denying the exemption to a taxpayer who lacks a survey or plat detailing the exempt property.
This bill was vetoed by the Governor on June 25, 2018, and that veto was overridden by the General Assembly on June 27, 2018. This section became effective June 27, 2018.

S750 - Health in Local Confinement/Veterinarians Controlled Substances/Wendell Holmes Murphy Freeway/Tax Due Date. (SL 2018-76)
S.L. 2018-76 does the following:

- Addresses health issues in local confinement facilities.
- Ensures State prisons are full participants in the NC Health Information Exchange, known as NC HealthConnex.
- Amends the duties of law enforcement officers related to involuntary commitment.
- Amends the North Carolina Controlled Substances Act and the Controlled Substances Reporting System pertaining to the practice of veterinary medicine.
- Requires continuing education for veterinarians on the abuse of controlled substances.
- Includes the North Carolina Veterinary Medical Board on the Prescription Drug Abuse Advisory Committee.
- Amends various budget provisions.

This act has various effective dates. Please see the full summary for more detail.

BILL ANALYSIS:

Section 1 requires that the medical examiner and the coroner must be notified immediately if a prisoner in the custody of a local confinement facility dies, regardless of the physical location of the prisoner at the time of death.
Section 2 requires the Department of Health and Human Services (DHHS) to study how to improve prisoner health screening with a goal of improving the determination that a prisoner in a local confinement facility has been prescribed life-saving prescription medications and a process to ensure the timely administration of those prescription medications. DHHS is required to report on or before November 1, 2018 to the JLOCHHS.
Section 3(a) requires the Department of Public Safety, DHHS, and the Government Data Analytics Center (GDAC) within the Department of Information Technology (DIT) to work collaboratively with organizations representing local government and law enforcement to facilitate the secure transmission of health information pertaining to prisoners in local confinement facilities through participation in the HIE Network, known as NC HealthConnex. **Section 3(b)** requires the Department of Public Safety, DHHS, and GDAC to ensure prison facilities are full participants in NC HealthConnex. **Section 3(c)** requires DHHS and GDAC, to provide an interim report to JLOCHHS on or before October 1, 2018 and a final report on or before October 1, 2019.
Section 3.1 increases by four percent the annual salaries of all State employees employed in positions based in State adult correctional facilities in effect on June 30, 2018.
Section 3.2(a) and **Section 3.2(b)** require a law enforcement officer to transport an individual under involuntary commitment proceedings to a facility or other location

identified by the LME/MCO in the community crisis services plan unless circumstances indicate the respondent appears to be suffering a medical emergency in which case the law enforcement officer will seek immediate medical assistance for the individual.

Section 4 clarifies a practitioner does not include a veterinarian for purposes of this section, which exempts a veterinarian from having to review patient information in the CSRS prior to prescribing a targeted controlled substance.

Section 5 states a veterinarian may continue to prescribe targeted controlled substances from valid written, oral or facsimile prescriptions. This further clarifies the exemption for a veterinarian from the electronic prescription requirement. The existing statute and this clarification are not effective until January 1, 2020.

Under current law, a dispenser who dispenses any Schedule II to V Controlled Substance must report prescription information to the CSRS.

Section 6 clarifies the definition of a dispenser for purposes of the requirements for CSRS includes a veterinarian when that person dispenses any Schedule II through V controlled substances. A veterinarian must report this prescription information to the CSRS. G.S. 90-113.73(g), as created by this section, states a veterinarian may submit prescription information by paper form or other means, provided all information required of electronically submitted data is submitted.

Under current law a practitioner may not prescribe more than a five day supply of any targeted controlled substance upon initial consultation and treatment of a patient for acute pain or prescribe more than a seven day supply of any targeted controlled substance for post-operative acute pain following a surgical procedure. **Section 7** exempts prescriptions for controlled substances wholly administered in an emergency facility, veterinary hospital or animal hospital as defined in G.S. 90-181.1, from the five day and seven day limitations on prescriptions for acute pain. Section 7 clarifies the definition of acute pain does not include pain treated as part of cancer care, hospice care or palliative care provided by a veterinarian. Section 7 modifies the definition of surgical procedure to include procedures performed by a veterinarian.

Section 8 requires the Veterinary Medical Board to require continuing education on the abuse of controlled substances as a condition of license renewal.

Section 9 adds the Veterinary Medical Board to the Prescription Drug Abuse Advisory Committee.

Section 9.2 requires the Department of Transportation to designate the portion of Interstate 40 in North Carolina from mile marker 380 to mile marker 385 the Senator Wendell Holmes Murphy, Sr. Freeway. **Section 9.5** clarifies the applicable date when a due date for taxes imposed for taxable years beginning on or after July 1, 2017 falls on a weekend, holiday or closure date.

EFFECTIVE DATE: The section clarifying a veterinarian may continue to prescribe targeted controlled substance from valid written, oral or facsimile prescriptions becomes effective January 1, 2020.

The section governing the transportation of an individual under involuntary commitment proceedings by a law enforcement officer is effective October 1, 2019 and applies to proceedings initiated on or after that date.

Veterinarians must report prescription information to the CSRS for dispensing any Schedule II through V controlled substances effective January 1, 2019. G.S. 90-113.73(g), as enacted by Section 6 of this act, expires effective October 1, 2019.

The section requiring the North Carolina Veterinary Medical Board to require continuing education on the abuse of controlled substances became effective June 25, 2018 and applies to renewal applications received in 2020.

The remainder of this act became effective June 25, 2018.

*Theresa Matula contributed to this Bill Summary.

S758 - Build NC Bond Act of 2018. (SL 2018-16)
S.L. 2018-16, The Build NC Bond Act of 2018, authorizes the issuance of up to $3 billion in special indebtedness to create an additional funding source for Build NC Projects, which consists of Division Needs Projects and Regional Impact Projects scheduled in accordance with the Strategic Transportation Investments law in Article 14B of Chapter 136 of the General Statutes.
This act becomes effective January 1, 2019 and expires December 31, 2028.

2017

H59 - Revenue Laws Technical Changes. (SL 2017-39)
S.L. 2017-39 makes technical changes to the Revenue Laws as recommended by the Department of Revenue.
The section of the act pertaining to tax credits for constructing a railroad intermodal facility became effective June 21, 2017 and applies to taxable years beginning on or after January 1, 2017. The remainder of this act became effective June 21, 2017.

H158 - Special Assessments/Critical Infrastructure. (SL 2017-40)
S.L. 2017-40 does two things:

- It authorizes a county or city to contract with a private party to construct a project on behalf of the county or city, and to reimburse the private party for costs incurred by the private party related to the project from the imposition of special assessments on the benefited property owners. The county or city would not be obligated to reimburse the private party any amount in excess of assessment revenues actually collected, less the entity's related administrative expenses.
- It clarifies who may be entitled to the proceeds of a performance guarantee issued by a developer to a county or city to assure successful completion of required improvements by the developer under a subdivision control ordinance.

This act became effective June 21, 2017, and applies to assessments made on or after that date.

H434 - Coins/Currency/Bullion Sales Tax Exemption. (SL 2017-181)
S.L. 2017-181 exempts from sales and use tax the sales of rare coins, paper currency, and precious metal bullion. This act became effective July 1, 2017, and applies to sales made on or after that date.

H548 - Equalize Treatment of Wastewater Products. (SL 2017-139)
S.L. 2017-139 exempts from sales and use tax wastewater dispersal products approved by the Department of Health and Human Services to equalize treatment among the various suppliers of these products. The act became effective July 1, 2017, and applies to sales made on or after that date.

S257 - Appropriations Act of 2017.
Sec. 10A.4: Personal Education Savings Account Program. (SL 2017-57)
S.L. 2017-57, Sec. 10A.4 establishes the North Carolina Personal Education Savings Account Program (PESA). A PESA is a bank account provided to a parent for the purpose of holding scholarship funds awarded by the State Education Assistance Authority (SEAA) for an eligible student to be used for certain qualifying education expenses. To be eligible for the scholarship, a student must reside in North Carolina, have not yet received a high school diploma and meet all three of the following requirements:

- Meet one of the following criteria:
- Was a full time student (i) assigned to and attending a public school pursuant to State law or (ii) enrolled in a Department of Defense Elementary and Secondary School located in North Carolina, during the previous semester.
- Received scholarship funds for a PESA during the previous school year.
- Is entering either kindergarten or the first grade.
- Is a child in foster care.
- Is a child whose adoption decree was entered not more than one year prior to submission of the scholarship application.
- Is a child whose parent or legal guardian is on full time duty status in the active uniformed service of the United States.
- Is a child enrolled part time in a public school and part time in a nonpublic school that exclusively provides services for children with disabilities.
- Has not enrolled in a postsecondary institution in a matriculated status eligible for enrollment for 12 hours of academic credit.
- Is a child with a disability.
- The SEAA must annually make applications available and select recipients for scholarships according to the following criteria:
- First priority must be given to eligible students who were awarded scholarship funds for a PESA during the previous school year if applications are made by March 1.
- After funds have been awarded to prior recipients, any remaining funds can be used to award scholarship funds for a PESA for all other eligible students.

The SEAA may verify information on any application for the award of a PESA, and household members of applicants must authorize access information needed for verification efforts held by other State agencies.
Scholarships will be awarded each year for up to $9,000 per eligible student, deposited in quarterly installments, subject to execution of a parental agreement. Funds will be accessible to the parent on a debit card with the prepaid funds loaded on the card, and parents will be required to submit quarterly expense reports. Parents of a PESA recipient must complete an annual written agreement to use at least a portion of the scholarship to provide an education to the eligible student in, at a minimum, the subjects of English language arts, mathematics, social studies, and science. The parent must also agree to

release the local education agency the student is eligible to attend of all obligations to educate the student while the student is receiving the PESA. PESA funds do not constitute taxable income to the parent, legal guardian, or legal custodian of an eligible student or to the eligible student.
Students who receive the PESA are also to receive an Opportunity Scholarship. Students who receive the PESA and an Opportunity Scholarship are also eligible to receive a Students with Disabilities Scholarship if the student has one or more of the following disabilities:

- Autism.
- Developmental disability.
- Hearing impairment.
- Moderate or severe intellectual disability.
- Multiple, permanent orthopedic impairments.
- Visual impairment.

A student's continuing eligibility for the scholarship must be assessed every three years by either the local education agency or a licensed psychologist with a school psychology focus or a psychiatrist.
PESA funds may only be used for the following qualifying education expenses of the eligible student:

- Tuition and fees for a nonpublic school that meets certain requirements.
- Textbooks required by a nonpublic school.
- Tutoring and teaching services provided by an individual or facility accredited by a State, regional, or national accrediting organization.
- Curricula.
- Fees for nationally standardized norm referenced achievement tests, advanced placement tests, or nationally recognized college entrance exams.
- Fees charged to the account holder for the management of the PESA.
- Fees for services provided by a public school, including individual classes and extracurricular programs.
- Premiums charged to the account holder for any insurance or surety bonds required by the SEAA.
- Educational therapies from a licensed or accredited practitioner or provider.
- Educational technology defined by the SEAA as approved for use.
- Student transportation, pursuant to a contract with an entity that regularly provides student transportation, to and from (i) a provider of education or related services or (ii) an education activity.

PESA funds may not be used for any of the following purposes:

- Computer hardware or other technological devices not defined by the Authority as educational technology approved for use.
- Consumable educational supplies, including paper, pen, or markers.
- Tuition and fees at an institution of higher education or a private postsecondary institution.
- Tuition and fees for a home school.

The SEAA is responsible for administration of the PESA program, including providing notifications to various State agencies, establishing rules and regulations for the administration of the program, including a lottery process for the selection of recipients within the criteria if necessary, contracting in the SEAA's discretion with a private financial management firm or institution to manage PESAs, and conducting annual audits of PESAs.
The SEAA must report annually by September 1 to the Joint Legislative Education Oversight Committee on the following:

- Total number, grade level, race, ethnicity, and sex of eligible students receiving scholarship funds.
- Total amount of scholarship funding awarded.
- Number of students previously enrolled in public schools in the prior semester by the previously attended local education agency.
- Nonpublic schools in which scholarship recipients are enrolled, including numbers of scholarship recipients at each nonpublic school.
- The number of substantiated cases of fraud by recipients and the number of parents or students removed from the program for noncompliance with the provisions of this Article.

EFFECTIVE DATE: This section became effective July 1, 2017. The PESA program applies beginning with the 2018-2019 school year. Changes to laws related to income tax are effective for taxable years beginning on or after January 1, 2018.

S257 - Appropriations Act of 2017.
Part 38: Finance Provisions. (SL 2017-57)
Part 38 of S.L. 2017-94 contains the following finance provisions:
Individual Income Tax

- Lowers the personal income tax rate from 5.499% to 5.25%, effective for taxable years beginning in 2019.
- Increases the standard deduction to $20,000 for married filing jointly taxpayers and to $10,000 for single filers, effective for taxable years beginning in 2019.
- Changes the standard deduction for head of household filers to an amount that is 75% of the amount for married filing jointly taxpayers, effective for taxable years beginning in 2019.
- Changes the child credit to a tiered child deduction, effective for taxable years beginning in 2018.

Corporate Income Tax

- Reduces the corporate income tax rate from 3% to 2.5% rate, effective for taxable years beginning in 2019.

Franchise Tax

- Reduces the franchise tax rate for S corporations by applying a flat $200 on the first $1 million of the calculated base, applicable to the calculation of franchise tax reported on the 2018 and later corporate income tax returns.

Sales Tax

- Exempts from sales tax distribution equipment, and accessories, attachments, or repair parts for distribution equipment, sold to a large fulfillment facility, effective July 1, 2017.
- Repeals the 1%/$80 privilege tax applicable to mill machinery and certain other manufacturing and industrial equipment and establishes a sales tax exemption for this equipment, effective July 1, 2018. It also directs the Revenue Laws Study Committee to study this area of law to provide more guidance to taxpayers and the Department of Revenue about what constitutes "mill machinery," how to define "manufacturing," and how to incorporate the body of Departmental administrative law in this area into the statutes.
- Exempts from sales tax repair or replacement parts for a ready mix concrete mill, regardless of whether the mill is freestanding or affixed to a motor vehicle, effective July 1, 2018.
- Provides a sales tax refund for building materials, supplies, and equipment sold to a business that receives a JDIG award prior to June 30, 2019, for a "transformative project," which is a project that requires an investment of $4 billion in private funds and creates at least 5,000 eligible positions.

Renewable Energy Tax Credit

- Allows certain biomass resource-related projects to claim the renewable energy tax credit if it had a certain minimum level of completion prior to January 1, 2016, and it was placed in service prior to May 5, 2017.

S326 - Clarify HUT & Improve Vehicle Titling Process.
Sec. 1: Clarify HUT. (SL 2017-69)
Section 1 of S.L. 2017-69 clarifies that the highway use tax applies to out-of-state vehicles when they are first titled in this State, effective June 28, 2017.

S391 - Ferry Transportation Authority. (SL 2017-120)
S.L. 2017-120 authorizes the creation of a Ferry Transportation Authority to operate a ferry system in the area of a tidal river, and adjoining estuaries, in the vicinity of a municipality that is only accessible by water.
This act became effective July 18, 2017.

S468 - QZAB Use Modification. (SL 2017-187)
S.L. 2017-187 makes modifications to the conditions for the award of Qualified Zone Academy Bonds (QZABs) by providing that the conditions established by the State Board of Education (SBE) for the uses of a QZAB allocation must be for one of the purposes permitted by federal law, and that the QZAB funds must be prioritized so that those funds are first used in Tier 1 counties determined to have greater economic distress and for schools where 75% or more of the school's students are eligible to receive free or reduced lunch under the federal lunch program.
Effective July 1, 2017, the act also authorizes award of grant funds from the Needs Based Public School Capital Fund for projects when a pre-development agreement for an operational lease was entered into on or before June 30, 2017.

Except as otherwise provided, this act became effective July 25, 2017, and applies to bond proceeds used on or after that date.

S615 - North Carolina Farm Act of 2017. (SL 2017-108)
S.L. 2017-108 made various changes to laws governing agricultural matters, including provisions involving the following:

- Agriculture and forestry awareness study commission studies
- Expand facilities exempt from EMC rule
- Present use-value change
- Abandoned livestock amendments
- Authority of the Department of Agriculture and Consumer Services to adopt and administer forest practice guidelines for purposes of the sedimentation pollution control act
- Assent to mutual aid provisions of the Great Plains Wildland Protection Compact
- Clarify activities incident to the farm and agritourism
- Eliminate county authority to adopt zoning regulations governing swine farms
- Allow food compliance inspectors to drive state vehicles without state tags and bumper stickers
- Meat and poultry technical corrections
- Modernize forest ranger statutes
- Allow emergency workers to receive worker's compensation when responding to non-fire emergencies
- Create exception from conservation benefit analysis for certain easements
- Exempt farm trucks that stay in State from having a USDOT identification number
- Exempt closure of hog lagoons from requiring the use of a professional engineer
- Exempt farm vehicles engaged in intrastate commerce from certain federal motor carrier safety regulations
- Authorize wine sales at farmers markets
- Allow extension of conditional exemption from sales and use tax for certain farmers
- Amend conditions that may be applied to agreements for the purchase of agricultural products

S628 - Various Changes to the Revenue Laws. (SL 2017-204)
S.L. 2017-204 makes various substantive, technical, clarifying, and administrative changes to the revenue laws. This act has various effective dates. Please see the full summary for more detail.

CURRENT LAW, BILL ANALYSIS, AND EFFECTIVE DATE:

Section	Bill Analysis	Effective Date
PART I. BUSINESS TAX CHANGES		
1.1	Removes unnecessary language in the franchise tax statutes.	August 11, 2017

1.2	Recognizes that a holding company may own companies that do not own stock.	August 11, 2017
1.3	Allows taxpayers to reduce the tangible property base for franchise tax purposes by the amount of any debt owed on the property. The adjustment was eliminated in the 2015 franchise tax simplification changes. The section also modernizes the statute. Subsection (c) of this section rewrites a provision in the budget bill, S.L. 2017-57, that reduces the franchise tax rate for S-corporations to include the technical changes made by this act.	The modernization changes became effective August 11, 2017. The reenactment of the deduction becomes effective for taxable years on or after Jan. 1, 2020
1.4	Specifies that a transferor of the historic tax credit for restoring non-income producing property must provide the transferee with information detailing the rehabilitation expenses and the credit amount	Taxable years on or after Jan. 1, 2017
1.5	Clarifies that petroleum-based liquid pipeline companies apportion income for corporate income and franchise tax based upon the number of barrel miles transported in this State. This change codifies	Taxable years beginning on or after
	subsection also modernizes the statute. This subsection becomes effective for taxable years beginning on or after January 1, 2017.	January 1, 2017.
1.6	Modifies corporate income tax deduction for interest expense paid or accrued to affiliates. Under current law, a corporation may deduct the greater of an amount limited to 15% of its adjusted taxable income or its proportionate share of interest paid or accrued by the affiliated group to an unrelated party. However there is no limitation on the deduction under certain conditions, such as if the recipient is subject to state tax on the interest income. The act eliminates the 15% provision. The act also clarifies that if one of the conditions is met, the Department cannot disallow the deduction by applying one of the rules of the regulations under Section 385 of the Internal Revenue Code	Taxable years on or after Jan. 1, 2017
1.7	Corrects a statutory cross-reference. The current statutory reference became obsolete when the income tax statutes were substantially changed, effective for taxable years beginning on or after January 1, 2014	Taxable years on or after Jan. 1, 2014
1.8	Corrects a statutory cross-reference.	August 11, 2017

1.9	An out of state owner in an S corporation or partnership is subject to North Carolina tax on the pro rata share of income attributable to North Carolina. This section clarifies that this amount includes guaranteed payments received in addition to profit distributions; the changes do not represent a change in the law.	Applicable to all taxable years
1.10	This section was removed by the conference report. [1]	
1.11	Subsection (a) clarifies that the additional rate of 0.74% applicable to the gross premiums on insurance contracts for property coverage is not part of the gross premiums tax, but is a special purpose assessment based upon gross premiums. Subsection (b) allows a taxpayer that elected to take a business and energy tax credit against the gross premiums tax for a taxable year prior to January 1, 2017, may take an installment or carryforward of the credit against the additional tax for taxable years beginning before January 1, 2017, but may not take an installment or carryforward of the credit against the additional tax for taxable years beginning on or after January 1, 2017. A taxpayer may apply to the Department for a refund of any excess tax paid to the extent the refund is the result of the benefit provided by this subsection. A request for a refund must be made on or before January 1, 2018. An request for a refund received after this date is barred. The issue of whether the special assessment is part of a taxpayer's gross premiums tax liability has been challenged. If the assessment is part of the tax liability, then a taxpayer may offset the liability with tax credits. This section codifies the Department's long-standing interpretation of the law, and provides some relief to taxpayers that failed to properly take an installment or carryforward of a business and energy tax credit against only the gross premiums tax by permitting them to take installments and	August 11, 2017
	carryforwards of that tax credit for taxable years beginning before January 1, 2017.	
1.12	Makes a technical change by changing "rates" to "rate" to reflect the fact that North Carolina has a single flat individual income tax rate.	August 11, 2017
1.13	Requires the filing of an annual report with the Secretary of State, rather than the Department of Revenue. The report would be due by the 15th day of the fourth month following the close of the corporation's fiscal year. This date coincides with the filing of the corporation's income tax return. Since 1998, most corporations have submitted their annual reports with their corporate income and franchise tax return. The General Statutes Commission recommended this change in the law in 1998 to make filing the annual report easier for corporations by allowing a single filing with one agency and to reduce inadvertent failures to file the annual report.	August 11, 2017

1.14	Under current law, a taxpayer seeking an extension of time to file a corporate franchise and income tax return or an individual income tax return must file an application with the Department, which can be submitted electronically. The NCACPA has expressed interest in the ability to use the filing of a federal extension to serve as an application for a State extension. However, the Department's current system functionality is unable to receive and process federal extension information. This section would require the Department of Revenue to study the feasibility of allowing the federal extension to be used as an application for a State extension, which will require contact with the IRS and identifying other states that use a similar process. The Department is directed to report its findings and recommendations to the Revenue Laws Study Committee by March 1, 2018.	August 11, 2017
PART II. SALES AND USE TAX CHANGES		
Last biennium, the General Assembly expanded the sales tax base to repair, maintenance, and installation (RMI) services. The Department of Revenue worked with Finance chairs, legislative staff, and interested parties to implement those sales tax changes. Sections 2.1 through 2.7 of this Part make technical, clarifying, and minor substantive changes to the sales tax applicable to RMI services and real property contracts. Section 2.8 of this Part provides transitional adjustments for retailers of RMI services and real property contracts. Section 2.8A of this Part provides tax relief to certain retailers in the hospitality industry. Section 2.12 provides a sales tax exemption from RMI services for certain aircraft. The remaining sections of this Part make technical, administrative, and clarifying changes to the sales tax laws.		
2.1	Moves definitions from G.S. 105-164.4H into the sales tax definition statute, G.S. 105-164.3. The following definitions have been amended to provide greater clarity: • Capital improvement. – Simplifies the definition and treats lessees of property the same as property owners. It also clarifies that painting provided as part of a repair, maintenance, and installation service is part of that service. • Free-standing appliance. – A new defined term. A free-standing appliance is tangible personal property and remains TPP once	Effective Jan. 1, 2017

	installed. It is taxable as TPP. There is a sales tax exemption for installation charges that are part of the sale price of TPP purchased by a real property contractor to fulfill a real property contract. GS 105-164.13(61c). • Landscaping. – Clarifies that landscaping modifies living elements. It does not include hardscape or services to items in pots or buildings. Provides that landscaping, by definition, is a capital improvement, and taxed accordingly. • Mixed transaction. – Clarifies that it is a contract for a capital improvement as well as a repair, maintenance, or installation service unrelated to the capital improvement. • Motor vehicle service contract. – Clarifies that the term includes a contract sold by a motor vehicle dealer on behalf of a motor vehicle service company. • Remodeling. – Clarifies the definition by using the language more similar to the language contained in the Department's directives and notices. • Repair, maintenance, and installation service. – Clarifies that the term includes the installation of an item being installed to replace a similar existing item when the replacement is not part of a capital improvement. The replacement of more than one of a like-kind item, such as more than one window, is a single RMI service.	
2.2	Clarifies that a sale of a free-standing appliance is a retail sale of tangible personal property. Removes an imposition that is unnecessary because the tax treatment of an item purchased by a real property contractor to fulfill a real property contract is addressed in G.S. 105-164.4H; provides a cross- reference to this tax treatment in G.S. 105-164.4(a)(16).	Effective Jan. 1, 2017
2.3	Clarifies the sourcing of services.	Effective Jan. 1, 2017

2.4	Makes changes to the statute that addresses the taxation of real property contracts. A transaction is taxable as a repair, maintenance, and installation service unless a person substantiates that the transaction is subject to tax as a real property contract. Subsections (a) and (b) of this section make the following changes to G.S. 105-164.4H: • G.S. 105-164.4H(a) and (b): Removes "services" because a real property contractor does not owe sales tax on services; the term should have been removed when the General Assembly removed the tax distinction between retailer-contractors and real property contractors. G.S. 105-164.4H(a1): Adds a new subsection to clarify that a transaction involving services to real property is a retail sale unless the person substantiates that a transaction is a real property contract. Provides that a person may substantiate a transaction as a real property contract by records or by receipt of an affidavit of capital improvement. A person who receives an affidavit of capital improvement is not liable for any additional tax due on transaction if the transaction is not a capital improvement. • G.S. 105-164.4H(b1): Repeals this subsection re: liability for unpaid sales and use taxes because the liability for unpaid taxes is already addressed in G.S. 105-164.6. • G.S. 105-164.4H(d): Makes a substantive change to mixed transactions by increasing the percentage of RMI services that may be taxed as part of a capital improvement from 10% of the contract price to 25% of the contract price. • G.S. 105-164.4H(e): Repeals this subsection because the definitions are moved to the definition statute, GS 105-164.3. Subsection (c) of this section revises G.S. 105-164.6 to include any necessary language from the repealed G.S. 105-164.4H(b1). The liability provisions need to be in one statute to avoid confusion and to ensure consistent tax treatment. • Subsections (d) and (e) of this section make technical and clarifying changes to related statutes.	Effective Jan. 1, 2017

2.5	Subsection (a) of this section repeals the list of transactions exempt from the tax on service contracts under G.S. 105-164.4I(b) because the list is moved to the sale tax exemption statute, G.S. 105-164.13. Subsection (b) clarifies that a contract to provide a certified operator for a wastewater system is not a taxable service contract. Subsection (a) of this section also repeals G.S. 105-164.4D(a)(6) because a service contract for tangible personal property, digital property, and services is a bundled transaction and subdivisions (1) through (5) of subsection (a) are sufficient to determine how to tax a bundled transaction. Transactions involving real property or services to real property cannot be a bundled transaction under the Streamlined Sales Tax Agreement. This subdivision (6) was added to address service contracts for real property. Subsection (b) of this section creates a new subsection under G.S. 105-164.4I, Service Contracts, entitled Mixed Service Contracts. This provision provides how a service contract for real property is taxable when one service is subject to tax and one is not. The rules are the same as currently exist for bundled transactions. The entire service contract is subject to tax unless the person determines an allocated price for the taxable portion of the contract based on a reasonable allocation of revenue supported by the person's business records; in that circumstance, tax applies to the taxable portion. If the taxable portion of the contract does not exceed 10% of the price of the contract, then the entire contract is exempt from tax.	Effective Jan. 1, 2017

2.6	Consolidates the sales tax exemptions into the sales tax exemption statute, G.S. 105-164.13. Clarifies that property or services used to fulfill a RMI service or a service contract remains taxable if the service or service contract is exempt from tax. Clarifies and expands the exemption for inspection reports. Removes the exemption for (i) landscaping services and (ii) services performed to resolve an issue that was part of a real property contract because both transactions are defined as a capital improvement. This change does not represent a substantive change. Currently, the items are listed as both an exemption and as a capital improvement. Removing the items from the exemption statute clarifies that the taxation of the property and services used to fulfill the real property contract. Defines "pest control" and "moving services" Adds an exemption for funeral-related services and services to animals, such as hoof shoeing and microchipping a pet. Moves the exemptions related to professional motorsports into one place. It makes no substantive change to this exemption.	Effective Jan. 1, 2017
2.7	Clarifies that the sales tax refund provided for interstate carriers applies to not only tangible personal property but also RMI services and service contracts. The effective date for this section is retroactive to the date RMI services became subject to sales tax.	March 1, 2016
2.8	Subsection (a) of this section allows a seller who paid sales tax on a product and used the product as part of a taxable RMI service, to offset the sales tax liability on the service with the sales tax paid on the products. This provision helps contractors and subcontractor who purchased and paid sales tax on items subsequently used in a taxable service. Subsection (b) of this section directs the Revenue Laws Study Committee to study the feasibility of providing such an option on an on-going basis. Subsection (c) of this section directs the Department of Revenue to take no action to assess tax due if a retailer meets all the conditions of this section. The section provides a grace period to retailers during this educational and transitional period.	Effective Jan. 1, 2017, and expires July 1, 2018 August 11, 2017 For period beginning on or after Mar 1, 2016, and ending before January 1, 2018

2.8A	Allows the Secretary of Revenue to reduce by 90% a sales tax assessment that involves the failure to properly collect sales and use tax on charges for vacation rental linens. The sales tax is a transactional tax. The sale or rental of tangible personal property is subject to sales tax under G.S. 105-164.4(a)(1). The receipts derived from an accommodation rental are subject to tax under G.S. 105- 164.4(a)(3). Since 2009, the Department has had a bulletin in place that lists various charges that are considered to be "derived from the rental of an accommodation." This list includes linen fees. When a linen rental company rents linens to a property management company, the transaction being taxed is the rental of tangible personal property, which is taxable under G.S. 105-164.4(a)(1). When those same linens are included as part of an accommodation rental by the property management company to a vacationer, the gross receipts derived from that accommodation rental are subject to tax under G.S. 105-164.4(a)(3). Since the sales tax is a transactional tax, the application of the law may have the effect of an item being taxed more than once if it is included in more than one transaction. Some members of the vacation rental industry have incorrectly interpreted or applied the law with respect to the rental of linens as part of a vacation rental and have been assessed by the Department. This section would permit the Department to reduce an assessment by 90% under the following circumstances: ☐ The taxpayer has remitted all of the sales and use taxes it collected for the audit period. ☐ The taxpayer had not been informed in a prior audit or requested a private letter ruling advising of the requirement to collect tax on the linen rental charges. ☐ The assessment is based on the incorrect application of the law with regard to collecting sales tax on separately stated linen charges or with regard to issuing resale certificates to the lessors of linens in error. ☐ The period at issue occurred prior to January 1, 2018. To get the reduction, the taxpayer must file a written request with the Department and file a request for review within 120 days following the receipt of a proposed assessment. In addition to the reduction, the Secretary may waive all penalties that were imposed as part of the assessment. See the notice published by the Department of Revenue: DOR notice - Taxaccomodations - Linens	August 11, 2017

2.9	Makes several technical and clarifying changes to the sales tax statutes, as requested by the Department: Subsection (a) of this section provides a cross-reference to the Qualifying Farmer sales tax exemption and clarifies that human blood, tissue, etc. is exempt from sales tax. This change makes no substantive change to the law. Subsection (b) of this section clarifies the nonprofit sales tax refund cap applies to the State's fiscal year, not the fiscal year of the nonprofit. Subsection (c) of this section corrects statutory references. Subsection (d) of this section corrects statutory references and modernizes the language. Subsection (e) of this section removes unnecessary language and clarifies when local use tax applies. Subsection (f) of this section corrects statutory references. Subsection (g) of this section removes unnecessary language. Subsection (h) of this section incorporates the rounding rules required under the Streamlined Sales Tax Agreement. Subsection (i) of this section updates the reference to the Streamlined Sales Tax Agreement.	August 11, 2017
2.10	Clarifies that an admission charge to an entertainment event sponsored by a farmer on farmland is not subject to sales tax. The Department receives this question often, especially during the fall when corn mazes and pumpkin patch events are prevalent. These events do not meet the definition of an entertainment event. This change does not make a substantive change to the law.	January 1, 2014
2.11	Subsection (a) of this section simplifies the collection and remittance of use tax due and payable on the repair and maintenance of a boat or aircraft. The change does not change the amount of use tax due on the repair and maintenance of a boat or aircraft. Subsection (b) of this section provides a cross-reference in the sales tax exemption statutes to the direct pay permit. The provision was also in Senate Bill 552, introduced by Sen. Cook.	August 11, 2017
2.12	Provides a sales tax exemption from RMI services for an aircraft with a gross take-off weight of more than 2,000 pounds. Currently, RMI services provided to a qualified aircraft are exempt from sales tax. A "qualified aircraft" is an aircraft with a maximum take-off weight of more than 9,000 pounds but not in excess of 15,000 pounds.	July 1, 2019

2.13	Provides that Sections 2.1 through 2.8 of this Part are effective retroactively to January 1, 2017. If any change made by these sections increases a sales or use tax liability, that change is effective when this act becomes law. Except as otherwise provided, the remainder of this Part is effective when it becomes law.	August 11, 2017
PART III. TAX COLLECTION AND ENFORCEMENT		
3.1	Creates a new crime for identify theft in the tax statutes. Currently, a person may be prosecuted for identity theft under Article 19C of Chapter 14 of the General Statutes. Under G.S. 14-113.20, an element of the crime is that the person must represent themselves as another person. Under Article 19C, identity theft is punishable as a Class G felony; it is punishable as a Class F felony if the person is in possession of identifying information pertaining to three or more persons. The new crime created by this section would not require the person to represent themselves as another person; it would be sufficient if the person fraudulently utilized identifying information of another person in a submission to the Department of Revenue to obtain anything of value, benefit, or advantage for themselves or another. Also, each person's identity obtained, possessed, or used would count as a separate offense. The crime of identity theft under the tax statutes would be punishable as follows: • Class G felony (maximum punishment of 47 months) • Class F felony (maximum punishment of 59 months) if a person suffers any adverse financial impact as a result of the identity theft.	December 1, 2017.
3.2	Requires a payment settlement entity (financial institutions) that submits credit card information to the IRS to also submit the information to the Department of Revenue. DOR requests this change to improve audit and examinations. Also requires electronic filing for reports submitted to the Department. Failure to file a timely report is subject to a $1,000 penalty.	August 11, 2017
3.3	Provides that taxes, debts, fines, penalties, or other obligations or amounts payable to a governmental unit are not voidable transactions under the Uniform Voidable Transactions Act.	August 11, 2017
PART IV. ADMINISTRATIVE CHANGES		

4.1(a)	Makes a conforming change because of a change enacted last year related to a taxpayer's request for a refund. If the Department determines that the taxpayer's request for a refund is outside the statute of limitations, the Department will issue a notice of denial. Under prior law, the taxpayer could only dispute the denial in superior court. In 2016, the General Assembly changed the law to allow a taxpayer whose claim for refund is denied because it was filed after the statute of limitations passed to appeal the determination before the Office of Administrative Hearings. A final decision by the administrative law judge on the denial is subject to judicial review. With this change, there are two kinds of "denials" issued by the Department subject to administrative review – a proposed denial of a refund claim and a denial of a refund claim when the basis for the denial is a determination by the Department that the claim is outside the statute of limitations. When the Department denies a taxpayer's claim for refund under either basis, it must send the taxpayer a notice. This subsection adds language to the notice requirement to reflect both kinds of denial.	August 11, 2017
4.1(b)	Requires a taxpayer to provide an explanation for the basis of the taxpayer's request for review of a proposed denial of a refund or a proposed assessment of tax. This explanation, however, would not prevent the taxpayer from raising other grounds for objecting to the Department's proposed denial of refund or proposed assessment during the conference process. Adds clarifying language regarding a request for review of a failure to pay penalty. Under current law, a taxpayer who does not request review of a proposed assessment may not request review of a failure to pay penalty based on that assessment. This provision clarifies that the failure to pay penalty is issued on a subsequent date in another notice.	See "Effective date" explanation below

4.1(c)	Provides for situations where the Department requests additional information from a taxpayer who has requested review of a proposed denial of a refund or a proposed assessment, and the taxpayer makes no response. In these situations, the cases remain pending, and the Department is unable to move them to collections unless they schedule a conference with the taxpayer and the taxpayer fails to show. The Department would like the ability to close out these cases where the taxpayer is nonresponsive. Under this section, the Department must make at least two attempts to obtain additional information in response to a request for review: the initial request and, if there is no response within the requested time frame, then the Department must reissue the request. The Department must give a taxpayer a minimum of 30 days to respond to the initial request and to the reissuance of the request. If there is no response to the second attempt, the Department must issue a "notice of inaction," which gives the taxpayer a final 10 days to respond. If there is no response to this notice, then the proposed denial of a refund or the proposed assessment becomes final. Once final, a proposed denial of a refund or a proposed assessment is not subject to further administrative or judicial review, and the Department may proceed with collection efforts. Conforming changes are found in Section 4.1(d) and Section 4.2(a).	See "Effective date" explanation below
4.1(d)	Clarifies that one of the possible actions by the Department in response to a taxpayer's request for review is that the Department may adjust the amount of the tax due or a refund owed. Clarifies that if a taxpayer requests review but thereafter pays the amount due, the Department may accept payment and take no further action on the request for review, unless the taxpayer states in writing that he or she wishes to continue the review. A situation like this may occur when a taxpayer wants to stop the accrual of interest on a proposed assessment. Under current law, when a taxpayer files a request for review, the Department can take one of three actions: (1) grant the refund or remove the assessment; (2) schedule a conference with the taxpayer; or (3) request additional information from the taxpayer. This subsection reworks the statute but effectively maintains the substance of the current law. Under the act, the three actions that could be taken by the Department are: (1) grant the refund or remove the assessment; (2) adjust the amount of the tax due or refund owed; or (3) request additional information. If none of these actions, or payment by the taxpayer of the amount owed, resolves the taxpayer's objections, then the Department would schedule a conference with the taxpayer.	See "Effective date" explanation below

	Effective date - For the above three subsections, which deal with changes to the request for review process, the effective date is when it becomes law. The provisions would apply to requests for review filed on or after that date and to pending requests for review. However, for pending cases, the Department must reissue a request for additional information, if one has previously been issued, allow the taxpayer time to respond, and notify the taxpayer that failure to respond will result in the matter becoming final and subject to collection efforts.	
4.1(e)	Changes the term "taxpayer" to "party" thereby allowing either a taxpayer or the Department of Revenue to appeal a decision of OAH to the Superior Court of Wake County. This change reflects current practice as described in the background below. The statutory framework for the administrative and judicial review of actions by the Department with respect to claims for refund and proposed assessment were substantially overhauled in 2007. Prior to 2007, these matters were heard before a hearing officer within the Department with the ability to appeal to the Tax Review Board. The 2007 rewrite changed the process to give taxpayers an independent hearing outside the Department. Under the current process, if a taxpayer and the Department are unable to resolve matters informally and internally, a taxpayer can file a contested case with the Office of Administrative Hearings, which can be further appealed to superior court. As part of the rewrite, G.S. 105-241.16 was revised to reflect these changes, providing that a *taxpayer* aggrieved by the decision in a contested case could appeal to Superior Court. It did not make any provision for the Department to appeal to Superior Court because of the way OAH decisions were handled at that time. Prior to 2011, OAH could only issue a "recommended decision." The decision was referred back to the originating agency, and the agency would issue a "final decision" that could be appealed to superior court. The authority to issue a final decision included the ability to change OAH's decision. Therefore, as a practical matter, when G.S. 105-241.16 was originally drafted in 2007, the Department would not have needed the authority to appeal to superior court because the Secretary could reverse an unfavorable OAH decision.[2]	Retroactive to January 1, 2012

	In 2011, the General Assembly changed the law to allow OAH to issue final decisions. G.S. 150B-43 was changed to state, "Any *party or* person aggrieved by the final decision in a contested case…is entitled to judicial review…"; previously, the statute only said "person." The change recognized that agencies, as well as aggrieved citizens, could seek judicial review of OAH final decisions. However, when this change was made, no corresponding change was made to G.S. 105-241.16, which also provides for judicial review of OAH decisions, but specifies that those cases must be heard in Business Court. The Department believes that the failure to make a conforming change to G.S. 105-241.16 in 2011 was an oversight and that it currently has authority under G.S. 150B-43 to appeal cases to Superior Court and are currently doing so. An interpretation otherwise would mean the Department of Revenue is one of the only, if not *the* only, agencies that may not seek judicial review of an adverse OAH decision, making OAH the final arbiter of tax cases in which the Department is the aggrieved party. Because the Department believes this is essentially a technical change, it has requested a retroactive effective date of January 1, 2012, which is the date the 2011 legislation, allowing OAH to render final decisions, became effective. It is worth noting that there is an ongoing lawsuit involving a sales and use tax assessment in which the taxpayer is alleging that the court lacks subject matter jurisdiction to hear the case based on G.S. 105-241.16.	

4.3 – 4.6	Changes terminology throughout the various excise tax statutes to clarify the license cancellation and revocation process and changes the term "license holder" to "licensee" throughout. Specifically, Section 4.3 makes these changes to the tobacco products statutes; Section 4.4 makes these changes to the motor carrier statutes; and Sections 4.5 and 4.6 make these changes to the motor fuel tax statutes. Makes two additional changes in the motor carrier statutes. Changes the term "registration" to "licensure" to be consistent with the International Fuel Tax Agreement (IFTA) which uses the term "licensing" throughout all of the IFTA manuals, and also to differentiate between "registering for the vehicle plate" which is completed through DMV or IRP. Adds the phrase "used in connection with any business endeavor" in G.S. 105-449.47 to make the statutory language consistent with the IFTA Articles of Agreement, which specifies that in order to qualify as a recreational vehicle, the vehicle shall not be used in conjunction with any business endeavor. Tobacco products dealers/distributors, motor carriers, and motor fuels suppliers, importers, and distributors are required to obtain a license from the Department of Revenue. There are circumstances under which the Secretary may "summarily cancel" a license, which means the Secretary cancels the license *prior* to holding a hearing on the matter, or the Secretary may "cancel" a license, which occurs only *after* holding a hearing. The term "cancel" is also used to refer to when a licensee voluntarily requests the cancellation of his or her license because, for example, the licensee is no longer engaging in business in the State. These sections change the terminology so that the term "cancellation" would refer only to an action taken by the Secretary upon a voluntary surrender, and the term "revocation" would refer to a "for cause" situation based on the noncompliance factors outlined in statute.	August 11, 2017
4.7	Amends the confidentiality statute to allow the Department to provide State tax information that relates to noncustodial parent location information to the Office of Child Support and Enforcement of the Department of Health and Human Services as required under federal law. This agreement to share information has previously existed with DHHS through a memorandum of understanding but has since expired. The provision is needed to be compliant with an IRS audit. Both Departments are in agreement to the provision.	August 11, 2017

4.8	Gives the Department of Revenue additional time to complete the transfer and consolidation of its information technology to the Department of Information Technology due to the heightened security requirements imposed by the federal government for purposes of sharing taxpayer information, which are not yet in place at DIT. It would put the Department of Revenue on the same footing as the Community Colleges, DPI, and the State Board of Elections, which have additional time to make the transition. The Department would have to report by October 1, 2018 to the Joint Legislative Oversight Committee on Information Technology on the progress of the transition plan.	Effective July 1, 2017
PART V. PROPERTY TAX		
5.1	Makes two changes to the Tax and Tag Program. The change made in subdivision (2)a. reflects the way the system is currently programmed. The change works best for counties and taxpayers. The changes made in subdivisions (2)d. and e. allows counties to bill only once a year, and charge the same amount of interest on unregistered vehicles as on registered vehicles. It treats vehicles the same, whether they are registered or unregistered with DMV.	Taxable years on or after July 1, 2017
5.2	Corrects a statutory reference.	August 11, 2017
5.3	Clarifies that all public service companies are treated the same when the value to a taxing unit amounts to less than $500.	August 11, 2017
5.4	Provides a property tax exemption for a mobile classroom or modular unit that is occupied by a school and is wholly and exclusively used for educational purposes, regardless of the ownership of the property. The term "school" includes a public school, a nonprofit charter school, a regional school, or a nonprofit nonpublic school, or a community college. Real property that is occupied by a charter school and is wholly and exclusively used for educational purposes regardless of the ownership of the property is currently excluded from property taxes, but mobile classroom are often treated as personal property.	Taxable years beginning on or after July 1, 2018
PART VI. OTHER CHANGES		
6.1	Allows money collected or received by a local government to be submitted to a cash collection service and eliminates the monthly deposit requirement if the money on hand is less than $500. Under current law, local governments must deposit collections daily. However, a board can approve that deposits be required only when the cash on hand is at least $250, but it must always be deposited by the last business day of the month.	Effective October 1, 2017

6.2	Allow an individual taxpayer to make an irrevocable election to direct all or part of an income tax refund to the Cancer Prevention and Control Branch, Division of Public Health (DPH), Department of Health and Human Services (DHHS), to be used for the early detection of breast and cervical cancer.[3] Check-off donations would be used for early detection of breast and cervical cancer in accordance with the NC Breast and Cervical Cancer Control Program. The General Assembly finds that the funds generated by the check-off donation are intended to be additional funding for early detection of breast and cervical cancer and are not intended to replace	Effective for taxable years beginning on or after January 1, 2017, and expiring for taxable years beginning on or after
	current appropriations. There are currently two other income tax refund check-offs: Wildlife Conservation Account and NC Education Endowment Fund.[4] The contents of this section were also in House Bill 164, introduced by Representatives Dollar, Howard, Stevens, and S. Martin.	January 1, 2021.
6.3	Corrects an interpretation of motor fuel excise tax change made by S.L. 2017-39. See the notice from the Department of Revenue: DOR notice - tax on ethanol and biodiesel	August 11, 2017
PART VII. EFFECTIVE DATE		
	Except as otherwise provided, this act is effective when it becomes law.	August 11, 2017

[1] This section would have made modifications to the gross premiums tax applicable to captive insurance companies

[2] NC Department of Revenue v. First Petroleum Servs. Inc.

[3] The donations must be distributed to the Cancer Prevention and Control Branch of the Division of Public Health of the Department of Health and Human Resources. website

[4] G.S. 105-269.5 and G.S. 105-269.7.

2016

H533 - Modify Present Use Value Exceptions to Disqualification.
Sec. 1: Modify Present Use Value Exceptions to Disqualification. (SL 2016-76)

Sec. 1 of S.L. 2016-76 pro rates deferred taxes when real property is transferred for less than its fair market value to a nonprofit entity for conservation or historical preservation, the State or a political subdivision of the State, or the United States.

This section became effective for taxes imposed for taxable years beginning on or after July 1, 2016

H533 - Modify Present Use Value Exceptions to Disqualification.
Sec. 2: Administrative Review of Statute of Limitations Determinations by Department of Revenue. (SL 2016-76)

Sec. 2 of S.L. 2016-76 allows a taxpayer to contest before the Office of Administrative Hearings the determination by the Department of Revenue that the taxpayer's amended return or claim for refund were filed outside the statute of limitations.

Sec. 2 of this act became effective June 30, 2016, and the act allows a taxpayer to appeal a past denial of an amended return or claim for refund due to the statute of limitations if the taxpayer appeals the denial within 60 days of June 30, 2016.

H1023 - Municipal Service Districts/Statutory Changes. (SL 2016-8)

S.L. 2016-8 requires additional accounting of certain contractors of cities with respect to municipal service districts, requires that an ordinance to establish a municipal service district be adopted at two separate meetings of the city council, and establishes a process by which property owners may petition for creation or reduction of a municipal service district. This act was recommended by the Legislative Research Commission Committee on Municipal Service Districts.

This act became effective June 1, 2016, and applies to contracts entered into on or after that date.

H1030 - 2016 Appropriations Act.
Sec. 6.1: Establishing or Increasing Fees. (SL 2016-94)

Sec. 6.1 of S.L. 2016-94 provides that:

- An agency is not required to consult with the Joint Legislative Commission on Governmental Operations prior to establishing or increasing a fee to the level authorized or anticipated in the Appropriations Act of 2016.
- An agency may adopt an emergency rule to establish or increase a fee as authorized by the Appropriations Act of 2016, if the adoption of a rule would otherwise be required by law.

This section became effective July 1, 2016.

H1030 - 2016 Appropriations Act.
Sec. 23.1: Insurance Regulatory Charge. (SL 2016-94)

G.S. 58-6-25 requires an annual insurance regulatory charge be levied on each insurance company, other than a captive insurance company. Sec. 23.1 of S.L. 2016-94 sets the

percentage rate to be used in calculating the insurance regulatory charge at 6.5% for the 2017 calendar year.

This section became effective July 1, 2016.

H1030 - 2016 Appropriations Act.
Sec. 38.1: Increase Zero Tax Bracket. (SL 2016-94)

Sec. 38.1 of S.L. 2016-94 increases the standard deduction by $2,000 over two years, beginning in 2016:

- $1,000 to $16,500 (married, filing jointly) for tax year 2016.
- $1,000 to $17,500 (married, filing jointly) for tax year 2017, and subsequent years.

This section became effective July 1, 2016.

H1030 - 2016 Appropriations Act.
Sec. 38.2: Expand Taxation of Mill Machinery. (SL 2016-94)

Sec. 38.2 of S.L. 2016-94, as amended by Secs. 11.1 and 11.3 of S.L. 2016-123, expands the preferential tax treatment of certain machinery and equipment subject to the 1% / $80 tax by adding provisions for the following:

- Parts, accessories, or attachments for equipment that is currently eligible for a company located at a ports facility. This provision became effective July 14, 2016, and applies retroactively to purchases made on or after July 1, 2013.
- Secondary metal recyclers, effective for purchases made on or after July 1, 2016. The equipment must be used in a process that converts ferrous or nonferrous metals or other items that have served their original purpose into new or different products for sale.
- Precious metal processors, effective for purchases made on or after July 1, 2016. This provision applies to a company that processes tangible personal property for the purpose of extracting precious metals regardless of whether the company owns the property being processed.
- Metal fabricators that derive more than $8 million annually from the fabrication or manufacture of metal products, effective for purchases made on or after July 1, 2016. This provision applies regardless of whether the products manufactured are for sale or for the company's own use.

H1030 - 2016 Appropriations Act.
Sec. 38.4: Market-Based Sourcing. (SL 2016-94)

Beginning in 2018, North Carolina will use a single sales factor apportionment formula for apportioning the corporate income and franchise tax liability of multistate corporations.

Single sales factor apportionment provides an incentive for multistate corporations to select North Carolina as their primary state to conduct business activities, unless the corporation provides a service instead of a product. Single sales factor apportionment does not provide the same incentive to a multistate company that provides services, because its sales factor is not based on the percentage of income derived from consumption of the company's services in the North Carolina marketplace. Consequently, states that adopt a single sales factor apportionment incentive usually adopt a market-based calculation of the sales factor for all multistate corporations, including those that provide services. This section does not enact market-based sourcing however; it does direct the Department of Revenue to adopt rules to implement market-based sourcing by January 1, 2017. The rules, if approved by the Rules Review Commission, cannot be entered into the Administrative Code until the General Assembly enacts market-based sourcing legislation and directs the Codifier of Rules to do so. The provision ensures that the General Assembly, and the public, will know what the rules pertaining to market-based sourcing would be if the General Assembly decides to enact market-based sourcing legislation in the future.

This section became effective July 14, 2016.

H1030 - 2016 Appropriations Act.
Sec. 38.5: Sales Tax Changes. (SL 2016-94)

Sec. 38.5 of S.L. 2016-94, as amended by Part XI of S.L. 2016-123, does the following:

- Provides a grace period for retailers who provide repair, maintenance, and installation services. This part of the section became effective July 14, 2016, and the relief provided for related transactions applies retroactively to January 1, 2015.
- Amends the sales tax on repair, maintenance, and installation services to treat similar transactions the same and to identify taxable transactions more clearly. In treating similar transactions the same, the act expands the sales tax base to include repair and maintenance of real property. This part of the section becomes effective January 1, 2017.
- Allows a use tax exemption equal to the amount of the installation charges and sales price of, or gross receipts derived from, the repair, maintenance, and installation services that exceed $25,000 for a boat, aircraft, or qualified jet engine. This part of the section became effective July 1, 2016.
- Repeals the $17.6 million State contribution to local sales and use tax revenue distributed to counties and cities, effective for fiscal years beginning on or after July 1, 2016. The contribution would have become effective July 1, 2016; thus, the repeal nullifies the contribution before it became effective.
- Allows a sales tax exemption for products made of more than 75% recycled material by weight if the products are sold for use in an accepted wastewater dispersal system. The exemption becomes effective October 1, 2016.

H1030 - 2016 Appropriations Act.
Sec. 38.6: Property Tax Exclusion Extension. (SL 2016-94)

Sec. 38.6 of S.L. 2016-94 continues to allow a property tax exemption for contiguous tracts of land donated to a nonprofit that were previously used for commercial or industrial purposes and significantly damaged by fire or explosion. The exemption was enacted in 2011 in response to the explosion of the ConAgra plant in June 2009.

This section became effective July 14, 2016. The property tax exemption is effective for taxable years beginning on or after July 1, 2011, and expires for taxable years beginning on or after July 1, 2021. Prior to the enactment of this section, the exemption would have expired for taxable years beginning on or after July 1, 2016.

H1035 - Local Government Commission/Training for Local Government Finance Officers. (SL 2016-84)

S.L. 2016-84 authorizes the Local Government Commission to require certain local government and public authority finance officers, or other employees who perform the duties of a finance officer, to attend training as to the powers, duties and responsibilities of a finance officer, and to charge a fee for the training.

This act became effective June 30, 2016.

S105 - Report Number of Veterans Filing Tax Returns. (SL 2016-112)

S.L. 2016-112 requires the Secretary of Revenue to provide a space on the individual income tax form D-400 for the voluntary disclosure of veteran status by persons filing State income tax returns, to use the information so disclosed to compile aggregate summary information on the number of veterans filing tax returns in North Carolina annually, and to provide this information to the Department of Military and Veterans Affairs.

This act became effective July 26, 2016

S481 - Fund Small Businesses/Department of Revenue Rulings/City Rights of Way. Part II: Public Disclosure of Written Determinations Made by the Department of Revenue. (SL 2016-103)

Part II of S.L. 2016-103 requires the Department of Revenue publish on its Web site redacted versions of written determinations responding to taxpayer questions within 90 days after the determination was issued.

This Part II became effective July 22, 2016, and the Department of Revenue must publish redacted versions of determinations issued on or after January 1, 2010, within 120 days of that date.

S575 - North Carolina/South Carolina Original Boundary Confirmation. (SL 2016-23)

S.L. 2016-23 addresses several legal and tax issues related to the reestablishment of the original boundary line existing between North Carolina and South Carolina. North Carolina and South Carolina created a Joint Boundary Commission to relocate and reestablish their 334-mile common boundary. The Commission began its work in 1995 and completed the technical part of its work by May of 2013. For the last three years, efforts have been underway to reduce or eliminate the impact of the work on property owners whose residency or business would be moved from South Carolina to North Carolina, or vice versa, because of the reestablished boundary line. This act addresses not only the tax consequences of the reestablished boundary line but also other issues, such as public education enrollment and drivers licenses. South Carolina enacted similar legislation in June 2016: Act 270, Ratified 292, and Senate Bill 667.

This act became effective June 22, 2016. It is anticipated that the process to complete the reestablishment of the boundary line will be completed by the end of this calendar year. The boundary must be approved by the Governor and the Council of State before the Governor may issue a proclamation declaring the reestablished line as the true boundary line between North Carolina and South Carolina.

S726 - Internal Revenue Code (IRC) Update. (SL 2016-6)

S.L. 2016-6, as amended by Sec. 1.2 of S.L. 2016-92, updates from January 1, 2015, to January 1, 2016, the reference to the Internal Revenue Code used in determining certain State tax provisions. The act does not conform to the extensions listed below under the federal Protecting Americans from Tax Hikes Act of 2015 (PATH Act), but it does conform to the $250 teacher expense deduction and to the income exclusion for amounts received by wrongfully incarcerated individuals.

The act does not conform to the following two provisions that were made permanent at the federal level:

- Enhanced Section 179 expensing.
- Tax-free distribution from IRAs to public charities.

The act does not conform to the following three provisions that were extended at the federal level through the 2016 taxable year:

- Deduction for higher education tuition expenses.
- Exclusion from income for forgiveness of debt on principal residence.
- Deduction for mortgage insurance premiums.

This act became effective on June 1, 2016. North Carolina has decoupled from the above-named provisions for taxable years beginning on or after 2013.

S729 - Various Changes to the Revenue Laws. (SL 2016-5)

S.L. 2016-5 makes various changes to the Revenue Laws including the following changes with broader impact:

- Limits the qualified interest expense deduction for interest paid to a related corporation to 15% (from 30%) of acorporate taxpayer'ss adjusted taxable income and allows an unlimited qualified interest expense deduction if the corporate taxpayer can trace the interest expense to a unrelated lender.
- Restores a miscellaneous itemized deduction applicable whenindividual taxpayerss restores a substantial amount held under claim of right that the taxpayer included in gross income for a prior taxable year because it appeared that taxpayer had an unrestricted right to that item.
- Adds a deduction forindividual taxpayerss who report business income on a Schedule C to equalize treatment of individual taxpayers and corporate taxpayers reporting ordinary and necessary business expenses where the expense was taken as a tax credit for federal purposes.
- Provides thatindividual taxpayerss must adjust federal adjusted gross income to prevent a double benefit of the federal net operating loss (NOL) carryover.
- Repeals thesales taxx exemption for items sold by a nonprofit organization when the receipts from the sale of the items will be directly or indirectly contributed to the State or school.
- Creates a newsales taxx exemption for food, prepared food, soft drinks, and other items of tangible personal property sold not for profit for or at an event that is sponsored by an elementary or secondary school when the net proceeds will be given to the school.
- Disallows the State governmentsales taxx exemption and sales tax refund of local taxes paid on indirect purchases for occupational licensing boards and State governmental entities that are specifically designated to apply for a sales tax refund under G.S. 105-164.14.

This act became effective May 11, 2016; however, most sections have an effective date based on the tax reporting period for the type of tax. Please see the full summary for additional detail.

Section	Bill Analysis	Effective Date
	PART I: BUSINESS TAX CHANGES	
1.1	Repeals the annual franchise or privilege tax on mutual burial associations. The Department of Revenue collected $750 in franchise tax on mutual burial associations in 2014. The General Assembly repealed most of the State	Taxes due on or after 4/1/17

	privilege license taxes in the mid-1990s as an archaic form of taxation. The tax rate varies from $15 to $50, depending upon the membership of the association. There are currently 60 to 65 mutual burial associations, and all but three have a tax liability of $15. Makes conforming changes to delete reference to repealed statute.	
1.3	Defines a "qualified air freight forwarder" as a company that is an affiliate of an airline and whose air freight forwarding business is primarily carried on with that affiliated airline. The provision allows a qualified air freight forwarder to utilize its affiliated airline's revenue ton miles factor for purposes of apportioning its income to North Carolina. Without this change, an air freight forwarder that owns no planes would be considered a service company and would be subject to the three-factor apportionment formula.	Taxable years beginning on or after 1/1/16
1.4	Corrects a statutory reference.	When law
1.5	Clarifies that an exercise of the royalty reporting option by a taxpayer does not affect whether the taxpayer has nexus and does not permit receipts to be excluded from the calculation of the sales factor.	When law
1.6	Excludes from the definition of "sales" that determine how much of a multistate corporate taxpayer's income is subject to tax in NC the following: (1) financial swaps and other similar financial derivatives and (2) certain receipts in the nature of dividends. Therefore, these transactions will not affect how much income is taxable in NC.	Taxable years beginning on or after 1/1/16
1.7	Corrects the effective date in Section 32.15.(g) of S.L. 2015-241 and Section 10.1(i) of S.L. 2015-268 which made changes to the corporate franchise tax base. The effective date was 1/1/17 and taxes due after 1/1/17. However, short-year 2016 tax returns would compute the 2017 franchise tax because the corporate franchise tax under G.S. 105-122 is computed on the basis of the books of the corporation as of the close of its income year. The corrected effective date will be for taxable years beginning on or after January 1, 2017. This effective date will apply the franchise tax base modifications to all franchise tax reported on the 2016 income and franchise tax return regardless of when the tax return is due.	When law
1.8(a)	Makes the definition of deductible interest expense paid between parent and subsidiary corporations consistent for in-State and out-of-State companies. The technical change makes the definitions parallel and clarifies the treatment of consolidated returns.	Taxable years beginning on or after 1/1/16
1.8(b)	Limits the qualified interest expense deduction for interest paid to a related corporation to 15% (from 30%) of a corporate taxpayer's adjusted taxable income and allows an unlimited qualified interest expense deduction if the corporate taxpayer can trace the interest expense to a unrelated lender.	Taxable years beginning on or after 1/1/16
1.9	Corrects the effective date for the deduction to prevent double taxation of income. The American Recovery & Reinvestment Act of 2009 in Internal Revenue Code section 108(i)(1) permitted an individual or a corporate taxpayer	Taxable years beginning

	with income from business indebtedness discharged by the reacquisition of a debt instrument occurring in 2009 or 2010 to defer that income until 2014. Beginning in 2014, the taxpayer is required to recognize the income ratably over a 5-year period for federal income tax purposes. NC decoupled from this federal law change in S.L. 2009-451. Therefore, the taxpayer has already recognized the income for State tax purposes. Sections 1.9, 2.1, and 2.4 of this bill address the State tax treatment of Internal Revenue Code section 108(i)(1).	on or after 1/1/09 Time barred refund claims allowed until 7/1/16 by section 6.1
PART II: PERSONAL TAX CHANGES		
2.1(a)	Restores a miscellaneous itemized deduction applicable when a taxpayer restores a substantial amount held under claim of right that the taxpayer included in gross income for a prior taxable year because it appeared that taxpayer had an unrestricted right to that item. This provision prevents a person from paying income tax on amounts the person did not receive. An example of this type of situation is a taxpayer who works on commission. The Department of Revenue recommended this change.	Taxable years beginning on or after 1/1/14
2.1(b)	Adds a deduction to prevent double taxation of income. The American Recovery & Reinvestment Act of 2009 in Internal Revenue Code section 108(i)(1) permitted an individual or a corporate taxpayer with income from business indebtedness discharged by the reacquisition of a debt instrument occurring in 2009 or 2010 to defer that income until 2014. Beginning in 2014, the taxpayer is required to recognize the income ratably over a 5-year period for federal income tax purposes. NC decoupled from this federal law change in S.L. 2009-451. Therefore, the taxpayer has already recognized the income for State tax purposes. In 2009, G.S. 105-134.6 was amended to provide a deduction from federal taxable income for this income. The deduction was inadvertently omitted from the list of deductions when G.S. 105-134.6 was recodified and amended as G.S. 105-153.5. Sections 1.9, 2.1, and 2.4 of this bill address the State tax treatment of Internal Revenue Code section 108(i)(1).	Taxable years beginning on or after 1/1/14 Time barred refund claims allowed until 7/1/16 by section 6.1
2.1(c)	Adds a deduction to equalize treatment of corporate taxpayers and individual taxpayers who report business income on a Schedule C. Corporate taxpayers may deduct ordinary and necessary business expenses for State purposes where the expense was taken as a tax credit for federal purposes under G.S. 130.5(b)(11). This section adds the same deduction (i.e., deduct business expenses for State purposes where a federal credit was taken in lieu of a deduction) for individual taxpayers. This deduction existed for individual taxpayers under repealed G.S. 105-134.6(d)(2). The deduction was inadvertently omitted from the list of deductions when G.S. 105-134.6 was recodified and amended as G.S. 105-153.5.	Taxable years beginning on or after 1/1/16
2.2(a)	Provides that an individual taxpayer must adjust federal adjusted gross income to prevent a double benefit of the federal net operating loss (NOL) carryover.	Taxabl e years

	NC piggybacks the federal NOL law, which instructs taxpayers to deduct the entire amount of NOL being carried to that year. If all of the NOL is not used, the unused amount is carried forward to the succeeding year. If North Carolina has additions to federal taxable income, they would be offset by the unused NOL and the taxpayer would also benefit from the unused NOL in the succeeding year. To prevent the double benefit, this addition to federal adjusted gross income is needed. The adjustment was required under G.S. 105-134.6, but was inadvertently omitted when G.S. 105-134.6 was recodified and amended as G.S. 105-153.5.	beginning on or after 1/1/16
2.2(a)	Provides that an individual taxpayer must add the amount deducted in a prior taxable year if the amount was withdrawn from the Parental Savings Trust Fund of the State Education Assistance Authority and not used for qualified higher education expenses unless the withdrawal was made without penalty under section 529 of the Code due to the death or permanent disability of the designated beneficiary. The adjustment was required under G.S. 105-134.6, but was inadvertently omitted when G.S. 105-134.6 was recodified and amended as G.S. 105-153.5.	Taxable years beginning on or after 1/1/16
2.3	Corrects a statutory reference and removes obsolete language.	When law
2.4	Adds a deduction to prevent double taxation of income. The American Recovery & Reinvestment Act of 2009 in Internal Revenue Code section 108(i)(1) permitted an individual or a corporate taxpayer with income from business indebtedness discharged by the reacquisition of a debt instrument occurring in 2009 or 2010 to defer that income until 2014. Beginning in 2014, the taxpayer is required to recognize the income ratably over a 5-year period for federal income tax purposes. NC decoupled from this federal law change in S.L. 2009-451. Therefore, the taxpayer has already recognized the income for State tax purposes. In 2009, G.S. 105-134.6 was amended to provide a deduction from federal taxable income for this income. The deduction was inadvertently omitted from the list of deductions when G.S. 105-134.6 was recodified and amended as G.S. 105-153.5. Sections 1.9, 2.1, and 2.4 of this bill address the State tax treatment of Internal Revenue Code section 108(i)(1).	Taxable years beginning on or after 1/1/09 Time barred refund claims allowed until 7/1/16 by section 6.1
PART III: SALES TAX CHANGES		
3.1	S.L. 2014-66 clarified the authority of the Department of Revenue to collect the 911 fee paid on prepaid wireless service. This section conforms the effective date of the collection authority to when the fee was initially imposed.	When law
3.2(a)	This subsection removes obsolete definitions and updates the statutory reference to the Streamlined Sales Tax Agreement.	When law
3.2(b)	Simplifies the sales tax application for storage by removing exceptions that are problematic to administer because taxpayers often do not retain sufficient documentation to support the exceptions to the definition of "storage".	1/1/17
3.3	Corrects a statutory cross-reference.	When law

3.4	The tax treatment for receipts from a ticket reseller was changed in S.L. 2014-3. This section makes a conforming change by recognizing who is the retailer for purposes of that transaction.	When law
3.5	Changes the term "affixed" to "applied" so the terminology is consistent with the terminology used in the definition and with the remainder of the statute.	When law
3.7	Replaces a term with the defined term.	When law
3.8	Changes the term "conditional service contract" to "conditional contract" so that the transactions in the statutory section will not be confused with a service contract. The transactions addressed in this section concern tangible personal property sold below cost if purchased with a contract. An example of this type of transaction is a mobile phone sold for a discounted price if purchased with a mobile phone plan. Sales tax applies to tangible personal property sold below cost with a contract. Under prior law, sale tax applied to the presumed sales price if the service in the contract was not taxable; and it applied to the part of the presumed sales price paid by the consumer if the service in the contract was taxable. The presumed sales price is the retail price at which the item would sell in the absence of the service contract. The prior law did not address the situation where part of the service was taxable and part of it was not. For example, a mobile phone contract may include not only taxable telecommunications service but also internet access service that is not taxable. This section clarifies what the presumed sales price of the item is when a portion of the conditional contract is taxable and a portion of it is not. It provides that the presumed sales price of the item is equal to the percentage of the service in the contract that is not taxable. It also makes a conforming change to the local sales tax base to clarify that the local sales tax applies to the presumed sales price.	When law
3.9	Subsection (a) repeals the sales tax exemption for items sold by a nonprofit organization when the receipts from the sale of the items will be directly or indirectly contributed to the State or school. An example of an entity that benefits from this exemption is a museum gift shop. Subsection (b) creates a new sales tax exemption for food, prepared food, soft drinks, and other items of tangible personal property sold not for profit for or at an event that is sponsored by an elementary or secondary school when the net proceeds will be given to the school.	1/1/17
3.11	Corrects a statutory reference and clarifies that fuel and piped natural gas exempt from sales tax (because it is sold to a manufacturer for use in connection with the operation of a manufacturing facility) remains taxable if it is used solely for comfort heating at a manufacturing facility where there is no use of fuel or piped natural gas in a manufacturing process.	1/1/17
3.12(a)	Provides that the sales tax exemption for items purchased by a contractor apply to items purchased for the holder of a conditional farmer exemption certificate	When law
	as well as the holder of a qualifying farmer exemption certificate.	

3.12(b)	Corrects a statutory reference.	When law
3.14	Repeals an obsolete provision.	When law
3.15	Removes the time period for which a person must maintain records. The three-year time period is misleading. Records should be retained for periods covered within a statute of limitations. The statute of limitations is generally three years. However, an ongoing audit may exceed a period of three years. There is no statute of limitations when a taxpayer fails to file a return.	When law
3.16	Adds "data" to the types of records the Secretary of Revenue may examine.	When law
3.17(a)	Makes changes necessitated by the Streamlined Sales and Use Tax Agreement. The change will allow certified service providers adequate time to make changes to their systems. This section also allows the Department to make adjustments as needed to the tax matrix used by certified service providers.	When law
3.17(b)	Changes the timing of any local tax rate increase from 2 months after the adoption of the tax increase to the calendar quarter after a minimum of 60 days' notice to sellers.	When law
3.18	Provides that a certified service provider may file with either the Secretary or the Streamlined Sales Tax Governing Board a certificate of deposit, in addition to a bond or an irrevocable letter of credit.	When law
3.19	This section clarifies that a park model RV is a recreational vehicle and is subject to the highway use tax. Under current law, it has been unclear whether a park model RV is subject to sales tax or highway use tax.	7/1/16
3.20	Clarifies that the white goods tax applies to any new white good purchased for storage, use, or consumption in this State.	7/1/16
3.21	Clarifies that the net proceeds of the One-Quarter Cent Local Option Sales Tax is allocated to the taxing county.	When law
3.22	Disallows the State government sales tax exemption and sales tax refund of local taxes paid on indirect purchases for (i) occupational licensing board and (ii) State governmental entities that are specifically designated to apply for a sales tax refund under G.S. 105-164.14. An occupational licensing board is defined by G.S. 93B-1 to be "any board, committee, commission, or other agency in North Carolina which is established for the primary purpose of regulating the entry of persons into, and/or the conduct of persons within, a particular profession or occupation, and which is authorized to issue licenses; … the term does not include State agencies, staffed by full-time State employees, which as a part of their regular functions may issue licenses." The NC Bar Association and the NC State Board of Certified Public Accountants are occupational licensing boards under that definition. As such, these entities would no longer be eligible for the State sales tax exemption.	7/1/17

3.23	Clarifies that the exemption for aviation gasoline and jet fuel applies to commercial aircraft in interstate or foreign commerce. The change adds "foreign commerce" to allow the exemption to apply where commercial aircraft fly directly to another country from NC. The effective date is retroactive to match the effective date of the enactment of the exemption.	1/1/16
3.24	Clarifies the sales tax exemption for service contracts on transmissions, engines, rear-end gears, and any other items purchased, leased, or rented by a professional motorsports racing team.	Applies retroactively to 1/1/14
PART IV: EXCISE TAX CHANGES		
4.1	Conforms the bonding requirements for entities that must pay excise tax on cigarettes and tobacco products. Provides that the entities must file a bond (or letter of credit) in an amount that is two times the monthly average liability of the taxpayer. The minimum amount of the bond is $2,000, the maximum amount of the bond is $2 million. The Secretary must periodically review the bonds, and adjust the amount based on changes in the taxpayer's liability.	When law
4.2	Clarifies the applicability of the tax on other tobacco products (OTP) to specify that the OTP rate does not apply to cigarettes that are taxed at 45¢ per pack and does not apply to vapor products that are taxed at 5¢ per mL of consumable product.	When law
4.3	Authorizes wine shippers to file excise tax returns on shipments once a year, rather than monthly. Sections 4.3 and 4.12 address wine shipper permittee filing annual reports.	When law
4.4	Conforms the bonding requirements for the severance tax on energy minerals to the provisions for other excise taxes. Clarifies that the tax is imposed on the producer of the energy mineral. Repeals a provision that would have relieved the producer of paying the tax. In Section 4.4(c), the phrase "prior to" is replaced with "after." The change allows severance producers to post a bond or irrevocable letter of credit after obtaining a permit under G.S. 113-395. The Department of Revenue requested this change to avoid a situation where the Department holds bond indefinitely until the producer receives the required permit.	When law
4.5	Makes three changes in regards to the disclosure of tax information: • Clarifies when information regarding sales by a nonparticipating manufacturer may be disclosed for reports required by the MSA. • Authorizes the Department to provide a list of entities licensed under the tobacco products tax Article to aid in the administration of the tobacco products tax. • Authorizes the Department to disclose tax information regarding motor fuel tax compliance to other IFTA (International Fuel Tax Agreement) jurisdictions.	When law

4.6	Conforms the statutes for temporary trip permits for motor carriers to the current Department practice.	When law
4.7	Authorizes the Secretary to appoint a designee to enter into agreements regarding the administration of IFTA. The agreements entered into may not impact the amount of motor fuel taxes due.	When law
4.8	Clarifies the interest rate applicable to IFTA taxpayers.	When law
4.9	Restores the calculation of the cost per gallon of motor fuel used when a taxpayer receives a refund of the motor fuel excise tax less the sales tax on the motor fuel. S.L. 2015-2 (Senate Bill 20) changed the calculation of the motor fuels excise tax rate. Conforming changes were made to the calculation of the tax refund on motor fuels excise tax. The conforming changes continued to authorize a refund of motor fuel excise tax less sales tax but omitted a method to calculate an average cost per gallon. Section 4.9 restores the method to calculate the average price per gallon of motor fuel. Prior to S.L. 2015-2, the calculation method used "average wholesale price." Section 4.9 follows S.L. 2015-2 and uses the Consumer Price Index Detailed Reports published by the Bureau of Labor Statistics of the United States Department of Labor for retail sales of motor fuels. The Department of Revenue requested this section.	1/1/16
4.10	Corrects cross references	1/1/16
4.11	The 2015 Budget Bill phased out the Noncommercial LUST Fund. Subsection (a) of this section clarifies the legislative intent by specifically providing that any revenue allocated from the ½ cent per gallon for various funds that is not distributed is to be distributed with the remaining excise tax revenue. Effectively, that means the 3/32 percent of the ½ cent per gallon revenue that is currently allocated to the Noncommercial LUST will be distributed to the Highway Fund and the Highway Trust Fund, effective with FY16-17. Subsection (b) of this section clarifies that distributions of the excise tax revenue to the Noncommercial LUST fund will be discontinued, beginning with FY16-17. For accounting purposes, the current date of June 30 creates ambiguity for the Department of Revenue as to how to distribute the funds from that one day's collections.	7/1/16
4.12	Makes conforming changes to G.S. 105-113.84 to allow wine shipper permittees to file an annual report. Sections 4.3 and 4.12 address wine shipper permittee filing annual reports.	When law
PART V: OTHER TAX CHANGES		
5.1	Extends the time period for which the Department may transfer an assessment against a responsible person.	When law
5.2	Repeals an obsolete statute.	When law
5.3	Repeals an antiquated statute in Chapter 131E, Public Hospitals, and puts the provisions pertaining to the taxability of public hospitals in the tax statutes,	When law

	Chapter 105. The antiquated statute refers to repealed taxes and contains a blanket statement that the authority is exempt from all taxes. In practice, hospitals apply for a refund of sales and use tax paid under G.S. 105-164.14. The property tax statutes exempt real and personal property of a hospital authority created under G.S. 131E-17 from tax, G.S. 105-278.1. This section exempts interest income from bond obligations from corporate and individual income tax and exempts motor fuel purchased by a hospital authority created under G.S. 131E-17.	
5.5	Replaces incorrect cross-references with the applicable wage, health insurance, and environmental impact standards, as they formerly existed in G.S. 105-129.83. Article 3J tax credits sunset for taxable years beginning on and after January 1, 2014. To be eligible for a tax credit under Article 3J, a taxpayer had to meet certain wage, health insurance, and environmental impact standards. Those standards were found in G.S. 105-129.83. Several grant programs and the sales tax exemption for qualifying datacenters refer to those standards.	When law
	PART VI: EFFECTIVE DATE	
6.1	General effective date is when act becomes law. Authorizes a tax refund even if barred by the statute of limitations (G.S. 105-241.6(a)) for a taxpayer that had an amount added to taxable income as deferred income under section 108(i)(1) of the Internal Revenue Code and the amount would be excluded under Sections 1.9, 2.1, or 2.4 of this bill. A request for a refund must be made on or before July 1, 2016.	When law Time barred refund claims allowed for IRC sec. 108(i)(1) until 7/1/16

Cindy Avrette and Trina Griffin substantially contributed to this summary.

S770 - North Carolina Farm Act of 2016.
Sec. 10: Extend Sunset for Constructing Certain Renewable Fuel Facilities. (SL 2016-113)

Sec. 10 of S.L. 2016-113 extends for three years the sunset for the tax credit for constructing a commercial facility that processes renewable fuel but only for a taxpayer that signed a letter of commitment with the Department of Commerce to that effect prior to September 1, 2013, and that began construction of the facility prior to January 1, 2014.

This section became effective July 26, 2016.

S791 - License Plate Agency Commission Contractor Rate Revision and Study. (SL 2016-120)

S.L. 2016-120 does the following:

- Effective October 1, 2016, directs the Division of Motor Vehicles (DMV) to study the issues with incorrect inspection stops on vehicles and the cumbersome process by which data on federal vehicle inspections is entered into the system. DMV must submit its findings and recommendations to the Joint Legislative Transportation Oversight Committee by December 1, 2017.
- Effective October 1, 2016, compensates a license plate agency commission contractor for the removal of an incorrect inspection stop on a vehicle at a rate of $1.30 per transaction.
- Provides that the $1.30 transaction fee is subject to quadrennial increase for inflation.

Except as otherwise provided, this act became effective July 28, 2016.

S803 - Revenue Laws Technical, Clarifying, and Administrative Changes. (SL 2016-92)

S.L. 2016-92 makes technical changes to tax statutes, including the following, that amend the result from prior law: (i) allows local governments to share confidential taxpayer information necessary to administer a tax; (ii) limits the look back period to determine the amount of a bond for a Non-Participating Manufacturer under the Master Settlement Agreement to the preceding three calendar years; and (iii) moves the date to calculate employers' tax rate for unemployment insurance taxes to September 1 to include tax payments made in the second quarter of the year.

S.L. 2016-92 generally became effective July 11, 2016; however, several provisions had other effective dates due to reporting periods. Please see the full summary for additional detail.

Section	Bill Analysis	Effective Date
PART I: INCOME TAX CHANGES		
1.1	Deletes a reference to the Interstate Commerce Commission. The Interstate Commerce Commission was abolished in 1995.	When law
1.2	Clarifies that taxpayers remain able to exclude amounts under the insolvency rules after NC decoupled from the extension of the income exclusion for the discharge of qualified principal residence indebtedness in S.L. 2016-6 (S726). A taxpayer that excludes from income cancellation of mortgage debt under federal law using either insolvency rules (NC conforms) or mortgage debt forgiveness rules (NC decoupled) is allowed to exclude the income for NC purposes to the extent a taxpayer qualifies for the insolvency provision under IRC section 108.	When law
PART II: SALES TAX CHANGES		

2.1	Adds the word "also" to clarify that the language added by Section 3.23(a) of S.L. 2016-5 (S729) was not intended to change the current law that exempts sales of aviation gasoline and jet fuel to an interstate air business for use in a commercial aircraft.	1/1/16
2.2	Corrects verb tense ("recommend" replaced with "recommended").	When law
2.3 2.4	Makes a conforming change to update the sales tax collection statute for facilitators who are liable for sales tax under existing law.	When law
2.5	Clarifies that the sales tax exemption for food and prepared food provided to a person under a prepaid meal plan subject to tax under G.S. 105-164.4(a)(12) also excludes the packaging items (e.g., wrapping paper, plastic bags, cartons, cups, napkins, straws) that are part of the sale and delivered with the food.	When law
2.6	Makes conforming change to comply with the Streamlined Sales and Use Tax Agreement to determine the effective date of a rate change for the combined general rate.	When law
2.7	Corrects a statutory reference.	When law
PART III: LOCAL GOVERNMENT TAX CHANGES		
3.1(a) 3.1(b)	Allows a county to disclose to a municipality in the county and the municipality to disclose to the county tax information necessary to administer a tax. Local tax records that contain information about a taxpayer's income or receipts are not public records and local government employees are prohibited from disclosing this information unless the disclosure is authorized by statute.	When law
PART IV: MSA CHANGES		
4.1(a)	Limits the look-back period to determine the amount of a bond for a Non-Participating Manufacturer (NPM) under the Master Settlement Agreement (MSA) to the preceding 3 calendar years. Current law is an unlimited look-back period meaning the bond amount for a NPM is based on sales volume occurring in the State at any time in the past. Sales of cigarettes are declining nationally and in the State. This change will reduce the bond amount for NPM with declining sales volume. The Attorney General's Office requested this change.	10/1/16
PART V: UI TAX CHANGES		

5.(a)	Moves the date to calculate employers' tax rate for unemployment insurance (UI) taxes to September 1 to include tax payments made in the second quarter of the year. Under current law, employers pay UI taxes quarterly during the month after the quarter ends. Tax payments affect tax rates that are calculated annually on August 1. Some tax payments made during July are not received by August 1 and are not used in the tax calculation on August 1. This change moves the calculation date to September 1 to allow all second quarter tax payments to be credited to employers. Delaying the calculation date of UI tax rates will more accurately set tax rates based on all second quarter payments.	When law. Applies to contributions payable for calendar quarters beginning on or after 1/1/17
PART VI: EFFECTIVE DATE		
6	Except as otherwise provided, this act is effective when it becomes law.	

Trina Griffin substantially contributed to this summary.

2015

H41 - Revenue Laws Technical Changes (SL 2015-6)
S.L. 2015-6 makes technical, clarifying, and administrative changes to the revenue laws. This act became effective April 9, 2015. Please see the full summary for more details.

H44 - Local Government Regulatory Reform 2015, Sec. 6: Preaudit Certifications (SL 2015-246)
Obligations incurred by a local government subject to the Local Government Budget and Fiscal Control Act and by a local board of education subject to the School Budget and Fiscal Control Act accounted for in a fund included in the budget ordinance may not be incurred unless the budget ordinance includes an appropriation authorizing the obligation and an unencumbered balance remains sufficient to pay in the current fiscal year for that amount. For written contracts, each must be certified by the finance officer, or a duly appointed deputy finance officer, to that effect, and is often called a "preaudit" certification. Sec. 6 of S.L. 2015-246 updates that statutory requirement to reflect advances in technology that allow for credit cards, gas cards, procurement cards, and other means of remitting payment for obligations.
This section became effective October 1, 2015, and applies to expenditures incurred on or after that date.

H97 - 2015 Appropriations Act, Sec. 28.2: Modify Collection Assistance Fee Rules (SL 2015-241)
Sec. 28.2 of S.L. 2015-241 modifies the use of collection assistance fees imposed on overdue tax debts by augmenting the allowable uses of the fees to include (i) applying the fee to costs of reducing the incidence of overdue tax debts, (ii) paying auditors responsible for identifying overdue tax debts, (iii) increasing the amount of proceeds that may be used for correspondence relating to collecting overdue tax debts from $500,000 to $750,000 per year, and (iv) to pay for upgrades to departmental computer systems for electronic filing of returns and issuance of refunds and for other mission-critical information technology

tasks approved by the Office of State Budget and Management in consultation with the State Chief Information Officer.
This section became effective July 1, 2015.

H97 - 2015 Appropriations Act, Sec. 29.27B: Adjust Distribution of Revenue from Motor Fuel Excise Tax Rate (SL 2015-241)
Sec. 29.27B of S.L. 2015-241 does the following:

- Amends the statutes that allocate revenue among various funds and accounts to adjust the amounts of motor fuel excise tax revenue allocated to the Highway Fund (from 75% to 71%) and the Highway Trust Fund (from 25% to 29%). This subsection became effective July 1, 2015, and applies to motor fuel excise tax revenue collected on or after that date.
- Effective June 30, 2016, amends the statutes that allocate revenue among various funds and accounts to repeal the amount of motor fuel excise tax revenue allocated to the Noncommercial Leaking Petroleum Underground Storage Tank Cleanup Fund.

H97 - 2015 Appropriations Act, Sec. 2.2(b): General Fund Availability Statement (SL 2015-241)
Subsec. (b) of Sec. 2.2 of S.L. 2015-241 repeals the reimbursement from the Highway Fund to the General Fund of the sales and use tax revenue not realized by the General Fund as a result of the statutory exemption for purchases by the Department of Transportation.
This subsection became effective July 1, 2015.

H97 - 2015 Appropriations Act, Sec. 29.34: Highway Use Tax Clarification (SL 2015-241)
Sec. 29.34 of S.L. 2015-241 clarifies that the maximum tax for out-of-state vehicles only applies if the motor vehicle has been titled in the name of the owner of the motor vehicle in another state for at least 90 days prior to the date of application for a certificate of title in this State.
This section became effective September 18, 2015.

H97 - 2015 Appropriations Act, Sec. 29.34A: Adjust Maximum Highway Use Tax Imposed for Certain Motor Vehicles (SL 2015-241)
Sec. 29.34A of S.L. 2015-241, as amended by Sec. 10.1 of S.L. 2015-268, increases the maximum highway use tax imposed for certain motor vehicles as follows:

- Class A or Class B Commercial Motor Vehicles. From $1,000 to $2,000.
- Recreational Vehicle. From $1,500 to $2,000.
- Out-of-State Motor Vehicles. From $150 to $250.

This section becomes effective January 1, 2016, and applies to sales made on or after that date, or for purposes of alternate tax for those who rent or lease motor vehicles, a lease or rental agreement entered into on or after that date.

H97 - 2015 Appropriations Act, Sec. 32.18: Sales Tax Base Expansion (SL 2015-241)
Sec. 32.18 of S.L. 2015-241, as amended by Sec. 10.1 of S.L. 2015-241, expands the sales tax base to include repair, maintenance, and installation of tangible personal property, effective March 1, 2016, as follows:

- Repeals the sales and use tax exemption applicable to installation charges when those charges are stated separately on the billing document.
- Imposes sales and use tax on the gross receipts derived from repair, maintenance, and installation services.
- Amends the definition of a "service contract" to include a contract where the obligor agrees to maintain or repair tangible personal property, regardless of whether the property is part of or becomes affixed to real property.

H97 - 2015 Appropriations Act, Sec. 32.19: Local Sales Tax Distribution (SL 2015-241)
Sec. 32.19 of S.L. 2015-241, as amended by Sec. 10.1(e1) of S.L. 2015-268, carves out a portion of the local option sales tax revenue and distributes that amount to the counties whose revenue-raising capacity from the local option sales taxes is less than it would be if the distribution of the revenue from the taxes was made on a per capita basis. The carve-out amount to be distributed in fiscal year 2016-2017 is $84.8 million. This amount is to be adjusted each fiscal year thereafter based upon the annual percentage change in the 2-cent local option sales taxes collected in the previous fiscal year. Seventy-nine counties will receive an allocation from the distribution. A county's allocation percentage is set by statute. The amount allocated to a county must be shared with the municipalities in that county. The General Assembly must periodically review the allocation percentages.
This section becomes effective July 1, 2016, and applies to local option sales and use taxes collected on or after that date and distributed to counties and cities on or after September 1, 2016.

H97 - 2015 Appropriations Act, Secs. 32.13, 32.14, 32.14A, and 32.15: Corporate Income and Franchise Tax Changes (SL 2015-241)
Secs. 32.13, 32.14, 32.14A, and 32.15 of S.L. 2015-241, as amended by Secs. 10.1 and 10.2 of S.L. 2015-268, make the following corporate income tax and franchise tax changes:

- Reduces the corporate income tax rate to 3%, effective for the taxable year that begins January 1 following the fiscal year in which the amount of net General Fund tax collected equals or exceeds $20,975,000,000.
- Expands the corporate income tax base by eliminating antiquated, obsolete, and special tax deductions, effective for taxable years beginning on and after January 1, 2016.
- Phases-in single sales factor apportionment over three years, starting with taxable years beginning on or after January 1, 2016 and directs the Revenue Laws Study Committee to study market-based sourcing.
- Simplifies the calculation of the franchise tax by conforming more closely to net worth as determined by generally accepted accounting principles, effective for franchise tax returns due in 2017. Increases the minimum franchise tax from $35 to $200 and increases the maximum franchise tax on holding companies from $75,000 to $150,000; both rate changes are effective for franchise tax returns due in 2017.

- Repeals the State privilege tax on banks, effective June 30, 2016.

H97 - 2015 Appropriations Act, Sec. 15.16B Municipal Service Districts/Contracts with Private Agency/Taxes/Study (SL 2015-241)

With respect to municipal service districts established by cities, Sec. 15.16B of S.L. 2015-241 does all of the following:

For all municipal service districts, the section requires the city to develop long-range plans and goals, set the tax rate in accordance with those plans and goals, and use the moneys collected for the purpose of those plans and goals. This provision becomes effective for tax imposed for taxable years beginning on or after January 1, 2016.

For municipal service districts created for historical districts, downtown revitalization, and urban revitalization, this section sets forth the following requirements on contracts with private agencies:

- Prior to entering into the contract the city must:
    - Solicit input from the residents and property owners as to the needs of the service district.
    - Use a bid process to determine which private agency is best suited to achieve the needs of the service district. If the city determines that a multiyear contract with a private agency is in the best interest of the city and the service district, the city may enter into a multiyear contract not to exceed five years in length.
    - Hold a public hearing.
- The city must require the private agency to report annually to the city, by presentation in a city council meeting and in written report, regarding the needs of the service district, completed projects, and pending projects.
- The contract is to specify the scope of services to be provided by the private agency. Any changes to the scope of services must be approved by the city council.

This provision became effective October 1, 2015, and applies to contracts entered into on or after that date.

Effective September 18, 2015, authorizes the Legislative Research Commission to study the feasibility of allowing property owners within a municipal service district to petition for removal from that municipal service district, and submit a report to the 2016 Regular Session of the 2015 General Assembly.

H97 - 2015 Appropriations Act, Sec. 32.16: Individual Income Tax Changes (SL 2015-241)

Section 32.16 of S.L. 2015-241 makes the following individual income tax changes:

- Reduces the tax rate to 5.499% in 2017 from the current rate of 5.75%.
- Increases standard deduction from $15,000 to $15,500 (for married filing jointly), effective for taxable years beginning on or after January 1, 2016.
- Allows unlimited medical deductions on Schedule A retroactive to January 1, 2015, to the extent a taxpayer can take the deduction at the federal level.

H97 - 2015 Appropriations Act, Sec. 29.27A: Adjust Municipal Vehicle Tax (SL 2015-241)

Sec. 29.27A of S.L. 2015-241 authorizes an annual municipal vehicle tax of $30 per vehicle resident in the city or town and places any local authorizations under the $30 cap. This section authorizes the tax for the following purposes:

- General purpose. Maximum $5 for any lawful purpose.
- Public transportation. Maximum $5 for financing, constructing, operating, and maintaining local public transportation systems if the municipality operates a public transportation system as defined in G.S. 105-550.
- Public streets. Any of the $30 authorization remaining for maintaining, repairing, constructing, reconstructing, widening, or improving public streets that are not a State highway.

This section becomes effective July 1, 2016.

H97 - 2015 Appropriations Act, Sec. 32.3: Historic Preservation Tax Credit (SL 2015-241)

Sec. 32.3 of S.L. 2015-241, as amended by Sec. 54.5 of S.L. 2015-264 and Sec. 10.1(b) of S.L. 2015-268, establishes a temporary tax credit for historic rehabilitation as described below. The tax credit becomes effective January 1, 2016, and applies to qualified rehabilitation expenditures incurred on or after that date. The credit will expire for expenses incurred on or after January 1, 2020.

- Income-Producing Propertyy. - A taxpayer is allowed a tax credit, capped at $4.5 million, that is equal to 15% of the first $10 million in qualified rehabilitation expenditures for an income-producing historic structure, plus 10% of the next $10 million, plus 5% for the first $20 million if the structure is located in a Tier 1 or 2 area, plus 5% for the first $20 million if the structure is located on an eligible targeted investment site.
- Non-Income Producing Propertyy. - A taxpayer is allowed a tax credit, capped at $22,500, that is equal to 15% of expenses to rehabilitate a building listed in the National Register of Historic Places or certified by the State Historic Preservation Officer as contributing to the historic significance of a National Register Historic District or a locally designated historic district certified by the United States Department of the Interior. The taxpayer must have at least $10,000 in expenses to qualify for the credit.

The credit also applies for certain 2014 and 2015 expenditures. Section 54.5 of S.L. 2015-264 (General Statutes Commission Technical Corrections Act of 2015) allows a taxpayer to claim the credit for expenses incurred in 2014 and 2015 if: (i) the historic structure is located in a Tier 1 or Tier 2 county; (ii) the structure is owned by a city; (iii) the rehabilitation activity commenced in 2014; and (iv) a certificate of occupancy is issued on or before December 31, 2015.

Finally, this section also modifies the expiration of the Mill Rehabilitation Tax Credit, which expired on January 1, 2015. Under prior law, as long as a taxpayer obtained an eligibility certification prior to the expiration date, the taxpayer could claim the credit whenever the

project was ultimately placed in service. This section provides that eligibility certifications will expire on January 1, 2023, so the availability of the credit is not as open-ended.

H117 - North Carolina Competes Act, Parts I and II: Job Development Investment Grant Program (JDIG) and One North Carolina Modifications (SL 2015-259)
Parts I and II of S.L. 2015-259 do the following:

- JDIG Modifications. - Section 1 of the act, as amended by Section 91 of S.L. 2015-264, extends the program, increases the amount that may be committed as grants under the program, provides additional commitment authority for high-yield projects, and makes other changes to the program. Except for a change in reporting requirements and the increase in the amount that may be committed, both of which became effective September 30, 2015, the remainder of this Part became effective October 1, 2015.
- One NC. - Section 2 of the act modifies the local match requirements to a tiered requirement: 3 State dollars for 1 local dollar for tier 1; 2 State dollars for 1 local dollar for tier 2; and an even local match for tier 3. This change became effective September 30, 2015.

H117 - North Carolina Competes Act, Parts III-VI: Sales Tax Changes (SL 2015-259)
Parts III through VI of S.L. 2015-259 make the following sales tax changes:

- Datacenter Infrastructure Act. - Part III creates a sales tax exemption for datacenters investing at least $75M within a 5-year period for sales of datacenter equipment and electricity located and used at the datacenter. The exemption becomes effective January 1, 2016, and applies to sales made on or after that date.
- Sales Tax Relative to Aviation. - Part IV (i) extends for 4 years the sales tax refund available to interstate passenger air carriers for sales tax paid on fuel in excess of $2.5M; (ii) exempts from sales tax fuel sold to an interstate air business for use in a commercial aircraft, effective January 1, 2016, taxes remaining sales of aviation gasoline and jet fuel at 7%, and earmarks the revenue from the tax to the Division of Aviation, Department of Transportation; (iii) increases the sales tax rate on aircraft and tax qualified jet engines at 4.75% with a maximum tax of $2,500, effective October 1, 2015; and (iv) exempts service contracts and repairs, maintenance, and installation services on qualified aircraft and qualified jet engines from sales tax, effective October 1, 2016.
- Exempt Motor Vehicle Service Contracts from Sales Tax. - Part V exempts service contracts on motor vehicles from sales tax. As part of the budget bill, S.L. 2015-241 (H97), sales tax is imposed on repair, maintenance, and installation services. The taxation of this service mitigates the need to impose the tax on service contracts and eases the administrative issues associated with the sales tax on service contracts for motor vehicles. This Part becomes effective March 1, 2016.
- Extend Sales Tax Preference for Motorsports Parts and Fuel. - Part VI, as amended by S.L. 2015-261, extends the current sales tax preferences for motorsports from January 1, 2016, to January 1, 2020, and clarifies the current sales tax on race engines and service contracts on items used by a professional motorsports racing team.

H117 - North Carolina Competes Act, Part VII: Tax Compliance and Tax Fraud Prevention (SL 2015-259)
Part VII of S.L. 2015-259 contains changes requested by the Department of Revenue that will give it the tools it needs to reduce the occurrence of stolen identities and refund fraud and to better ensure tax compliance.
This Part has multiple effective dates; please see the full summary for more detail.

H163 - Captive Insurance Amendments (SL 2015-99)
S.L. 2015-99 makes enhancements and various technical and substantive statutory changes to the laws governing captive insurance companies in the State, as recommended by the Department of Insurance.
This act became effective June 19, 2015.

H168 - Exempt Builders' Inventory (SL 2015-223)
S.L. 2015-223 exempts the increase in value of certain improvements to real property held for sale by a builder:

- For residential real property, a builder may exclude for 3 years the increase in value due to subdivision, improvements, and buildings that are either a new single-family residence or a duplex.
- For commercial property, a builder may exclude for 5 years the increase in value due to subdivision and improvements - excluding buildings.

To qualify as a builder, the property owner must be in the business of buying real property, making improvements to it, and then reselling it. The owner is not required to be licensed as a general contractor.
S.L. 2015-223 will become effective for taxes imposed for taxable years beginning on July 1, 2016, and apply to subdivision of or other improvements made on or after July 1, 2015.

H229 - Church Tax Exemption/Driving Privileges (SL 2015-185)
S.L. 2015-185 exempts religious buildings that are under construction from local property tax, effective for taxes imposed for taxable years beginning on or after July 1, 2015.
The act also authorizes a judge to allow a person with a revoked driver's license to drive to attend religious worship under a limited driving privilege, effective October 1, 2015, and applies to limited driving privileges issued on or after October 1, 2015.

H912 - Taxation of Tribal Land and Tobacco Products (SL 2015-262)
S.L. 2015-262 does the following three things:

- It exempts from property tax real and personal property located on lands held in trust by the United States for the Eastern Band of Cherokee Indians, regardless of ownership, effective for taxes imposed for taxable years beginning on or after July 1, 2016.
- It allows the Department of Revenue to enter into an agreement with the Eastern Band of Cherokee Indians regarding the excise tax on tobacco products.
- It clarifies the legislative intent of Section 4 of S.L. 2015-98 (ABC Omnibus Legislation) to provide that distillers who sell bottles of liquor at the distillery are not required to remit portions of the cost of the bottle to the State warehouse or the

local ABC board. [For a more detailed explanation of this provision, please see the summary for S.L. 2015-98 (HB 909) in the ALCOHOLIC BEVERAGE CONTROL subject area].

Except as otherwise provided, this act became effective September 30, 2015.

S20 - Internal Revenue Code Update/Motor Fuel Tax Changes (SL 2015-2)
S.L. 2015-2 consists of two Parts. The first Part, which was a recommendation of the Revenue Laws Study Committee, updates from December 31, 2013, to January 1, 2015, the reference to the Internal Revenue Code used in determining certain State tax provisions. The act decouples from the extensions listed below under the federal Tax Increase Prevention Act of 2014 for the 2014 tax year, but it conforms to the $250 teacher expense deduction. Enhanced Section 179 expensing

- Exclusion from income for forgiveness of debt on principal residence.
- Deduction for mortgage insurance premiums.
- Deduction for higher education tuition expenses.
- Tax-free distribution from IRAs to public charities.

This Part became effective March 31, 2015.
The second Part of the act makes the following changes to the motor fuels tax:

- Reduces the motor fuels tax rate from 37.5 cents to 36 cents beginning April 1, 2015, through December 31, 2015. It sets the rate at 35 cents per gallon (cpg) from January 1, 2016, through June 30, 2016, and at 34 cpg from July 1, 2016, through December 31, 2016.
- Changes the variable component of the formula for determining the rate. Beginning January 1, 2017, the rate will be 34 cpg multiplied by a percentage reflecting population change and the annual change in the Energy component of the Consumer Price Index for all Urban Consumers as produced by the U.S. Bureau of Labor Statistics.
- Replaces the two 6-month base periods used in determining the gas tax rate with a single 12-month base period.
- Makes $3.35 million and $10.1 million reductions in the Highway Trust Fund and Highway Fund budgets for the 2014-2015 fiscal year.

The motor fuels tax rate changes are effective as described above. The remainder of this Part became effective March 31, 2015.

S159 - Corrected Revaluations/Minimal Refunds/Property Taxes (SL 2015-266)
S.L. 2015-266 clarifies the process by which undervalued property is to be taxed under reappraisals conducted under S.L. 2013-362 (Require Certain General Reappraisals), and authorizes local governments to not mail minimal property tax refunds.
This act became effective October 1, 2015.

S273 - Motor Vehicle Tax: Waive Penalties/Interest (SL 2015-204)
S.L. 2015-204 authorizes counties to reduce or waive interest or penalties on delinquent motor vehicle taxes for tax years prior to July 1, 2013.
This act became effective August 11, 2015.

S372 - Renewable Energy Safe Harbor (SL 2015-11)
S.L. 2015-11, as amended by Sec. 54.3 of S.L. 2015-264, provides a delayed sunset for the credit for investing in renewable energy credit for the following taxpayers:

- Taxpayers that have incurred at least 80% of the costs, and partially constructed at least 80% of a project with less than 65 megawatts of capacity by January 1, 2016.
- Taxpayers that have incurred at least 50% of the costs, and partially constructed at least 50% of a project with 65 megawatts of capacity or more by January 1, 2016.

This act became effective April 30, 2015.

S399 - Joint Agency Tax Refund (SL 2015-235)
S.L. 2015-235 allows a joint agency created by interlocal agreement for the purposes of fire protection, police protection, and emergency services to receive a refund of sales and use taxes paid by it. This provision became effective July 1, 2015, and applies to purchases made on or after that date.
The act also directs the Revenue Laws Study Committee to study how the exemption from the motor fuels tax is applied to entities that are comprised of multiple local government units.
Except as otherwise provided, this act became effective September 1, 2015.

S448 - Equalize Tax on Propane Used as a Motor Fuel (SL 2015-224)
S.L. 2015-224 amends the motor fuels tax applicable to liquefied propane gas used as a motor fuel by specifying that the per gallon motor fuel tax rate is applied to the gas gallon equivalent of liquefied propane gas. The gas gallon equivalent is 5.75 pounds of liquefied propane gas.
This act becomes effective January 1, 2016.

S513 - North Carolina Farm Act of 2015, Sec. 2: Conform Compensation Paid to an H-2A Agricultural Worker to Federal Wage Withholding Standards (SL 2015-263)
Sec. 2 of S.L. 2015-263 provides that an employer does not have to withhold State income tax on compensation paid to an H-2A agricultural worker if the employer is not required to withhold federal income tax on that compensation. Since calendar year 2011, an employer must report compensation of $600 or more paid to an H-2A agricultural worker on Form W-2, but the employer is not required to withhold federal taxes on the compensation unless the worker fails to provide the employer with either a Social Security Number (SSN) or an Individual Taxpayer Identification Number (ITIN). In the case of an H-2A agricultural worker who fails to provide a SSN or ITIN, the employer must withhold and remit 28% of the compensation and continue withholding this amount until the worker furnishes the employer the SSN or ITIN.
This section is effective for taxable years beginning on or after January 1, 2015.

S513 - North Carolina Farm Act of 2015, Sec. 12: Present-Use Value Modifications (SL 2015-263)
Sec. 12 of S.L. 2015-263 makes three changes to present-use value taxation:

- Provides that, for purposes of present-use value, the commercial production or growing of animals includes the rearing, feeding, training, caring, and managing of horses.
- Provides that when a tax assessor is determining whether a business entity applicant for present-use value has farming as its principal business, there is a rebuttable presumption that farming is the business entity's primary business if the applicant has been approved for present value taxation for a qualifying property in another county. Any determination about the applicant's eligibility does not affect the determination of whether the individual parcel of land meets the classifications for agricultural, horticultural, or forest land pursuant to G.S. 105-277.3. Further, if the assessor is able to rebut the presumption, this does not invalidate a determination that the applicant's principal business is farming agricultural land, horticultural land, or forestland in the other county.
- Effective September 30, 2015, directs the Department of Revenue to annually publish a present-use value program guide and make the guide available on its Web site. Tax assessors must adhere to the Department's guide when making decisions regarding the qualifications or appraisal of property for the present-use value taxation program.

Except as otherwise provided, this section became effective July 1, 2015, and applies to taxes imposed for taxable years beginning on or after that date.

S621 - Registration Renewal Notice/E-Mail (SL 2015-108)
S.L. 2015-108 authorizes the Division of Motor Vehicles to send the required combined vehicle property tax and State registration notice by e-mail, subject to the written consent of the owner of a vehicle.
This act becomes effective January 1, 2016.

S682 - Modify Sunset Regarding Contingent Audits (SL 2015-109)
S.L. 2015-109 makes permanent the prohibition, established in 2012, on local governments from using third-party contractors paid on a contingent fee basis for audit and assessment purposes.
This act became effective June 24, 2015.

2014

OMNIBUS TAX LAW CHANGES.

Session Law	*Bill #*	*Sponsor*
S.L. 2014-3	**HB 1050**	**Rep. Howard, W. Brawley, Lewis, Setzer**

AN ACT TO AMEND THE REVENUE LAWS, AS RECOMMENDED BY THE REVENUE LAWS STUDY COMMITTEE.

This act consists of fifteen Parts, each of which is separately summarized below.

PART I: DEDUCTION FOR STATE NET LOSS

SUMMARY: Part I of the Omnibus Tax Law Changes bill replaces the corporate net economic loss deduction with a State net loss deduction for taxable years beginning on or after January 1, 2015.

CURRENT LAW: Both federal and State tax law provide relief to a corporation that incurs more expenses than revenues during the taxable period. For federal tax purposes, a corporation is allowed a net operating loss deduction equal to the amount by which tax deductible expenses are more than taxable revenues. The federal deduction may be carried back two years preceding the loss year, thus providing immediate tax relief in the form of a tax credit; any unused portion of the deduction may be carried forward for 20 years. For State tax purposes, a corporation is allowed a net economic loss deduction[5] equal to the amount by which allowable deductions for the year other than prior year losses exceed income from all sources in the year, including nontaxable income.[6] The State deduction may be carried forward 15 years; any loss carryforward must first be offset by nontaxable income, including allowable deductions.

BILL ANALYSIS: This Part does three things to simplify the calculation and ease the administration of the corporate loss deduction, effective for taxable years beginning on or after January 1, 2015:

- It replaces the net economic loss calculation with a State net loss calculation that is more comparable to the federal net operating loss calculation.
- It removes the requirement that a net economic loss carried forward to taxable years beginning on or after January 1, 2015, be first offset by nontaxable income.
- It instructs the Secretary of Revenue to apply the standards under sections 381 and 382 of the Code when determining to what extent a loss survives a merger or an acquisition.

The Part replaces the State's net economic loss deduction with a State net loss deduction. The State net loss would be the amount by which allowable deductions for the year, other than prior year losses, exceed gross income under the Code for the year adjusted as provided in G.S. 105-130.5. Adjustments under G.S. 105-130.5 include items such as the adjustments taxpayers must make when the State decouples from federal accelerated depreciation and expensing. If the taxpayer is a multi-state corporation with business within

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[5] NC is the only state with a net economic loss deduction that differs significantly from the federal net operating loss deduction. Other states that have a corporate income tax loss deduction use a calculation that is comparable to the federal net operating loss deduction.

[6] Nontaxable income includes income that has been deducted in computing State net income, nonapportionable income that has been allocated directly to another state under G.S. 105-130.4, and any other income that is not taxable under State law. Prior to August 17, 2013, the Department of Revenue interpreted G.S. 105-130.8 to require items deductible under G.S. 105-130.5, such as U.S. government interest and dividends, to be considered in the computation of the loss in the year of creation as nontaxable income. The Department revised its interpretation to recognize that an allowable deduction, although not taxable, may not reduce a loss in the year the loss is created. However, pursuant to G.S. 105-130.8(a)(3), the Department continued to require that a loss carried forward to a subsequent year must first be offset by any income not taxable, including allowable deductions under G.S. 105-130.5.

and without North Carolina, then the loss must be allocated and apportioned in the year of the loss in accordance with G.S. 105-130.4.

The repeal of the net economic loss deduction removes the applicability of North Carolina case law that governs the extent to which a net economic loss survives in a merger or an acquisition. The Part instructs the Secretary of Revenue to apply the federal regulations adopted under sections 381 and 382 of the Code in determining the extent to which a loss survives in a merger or acquisition. Although the provisions of the Code would be applied, the loss limitations may differ at the State level based upon the single entity reporting requirement in North Carolina and subject to the allocation and apportionment provisions of G.S. 105-130.4 in the year of the loss.

The Part changes the calculation of a net economic loss carry-forward. Under current law, the carry-forward must be reduced by nontaxable income. What constitutes nontaxable income has been a source of questions, disagreements, and litigation. Under the change made by this Part, the amount of the net economic loss, as determined on December 31, 2014, becomes a static amount. Any unused portion of a net economic loss carried forward in taxable years beginning on or after January 1, 2015, would be administered in accordance with the State net loss statute:

- Any unused portion of a net economic loss would not have to first be offset by nontaxable income.
- The standards under sections 381 and 382 of the Code would be applied in determining the extent to which a net economic loss survives a merger or acquisition that occurs on or after January 1, 2015.

EFFECTIVE DATE: This Part becomes effective for taxable years beginning on or after January 1, 2015.

PART II: OTHER INCOME TAX CHANGES

SUMMARY: Part II makes technical and clarifying changes to various income tax laws.

CURRENT LAW, BILL ANALYSIS, AND EFFECTIVE DATE: This Part makes the following technical and clarifying changes to the income tax laws.

Section 179 expense deduction

Section 2.1 makes two changes to the section 179 expense deduction for State income tax purposes to reflect the intent of legislative action taken in 2013.

First, it corrects the dollar amount of the section 179 expense investment limit. In the American Taxpayer Relief Act of 2013, Congress extended the $500,000/$2,000,000 accelerated section 179 expense deduction allowances for 2013 and 2014. The intent of S.L. 2013-10 was to decouple from this federal provision and return to the limits that would have been applicable under the Code as written in December 2010. The act erroneously referred to the Code as defined in May 2010. The Code was amended three times in 2010, and the changes included three different section 179 expense limits. S.L. 2013-414 rewrote the statutes that decouple from the federal accelerated depreciation expensing to make them clearer to understand. As part of the rewrite, the subsection decoupling from the section 179 expense limits sets forth the limits as opposed to referring to the Code on a certain

date. In setting forth the limits, the dollar amount of the investment limit should have been $200,000 rather than $125,000.

Second, it makes changes to ensure that qualifying taxpayers may receive the benefit of the add-back deductions. Beginning in 2002, Congress has allowed taxpayers to depreciate certain assets more quickly than would otherwise be allowed – 100% bonus depreciation and section 179 expense deductions. Many states, including North Carolina, have decoupled from those provisions primarily because the fiscal impact of conforming to the greater depreciation rules would have been too costly. Instead of granting the larger depreciation in the initial years, North Carolina required taxpayers to add-back 85% of the deduction in the first year and to deduct 20% of this amount over the next five years. Taxpayers who changed their form of business entity or who merged with subsidiaries within the five-year period of deductions were not allowed to take the remaining deductions because the taxable entity that made the add-back and received the initial deductions either no longer existed or no longer owned the depreciable asset. The result in some cases was that the asset did not receive the full benefit of the deduction. S.L. 2013-414 changed the law to allow the transferee of an asset, where the tax basis of the transferred asset carried over from the transferor to the transferee for federal income tax purposes, to add any remaining deductions to the basis of the transferred asset and to depreciate the adjusted basis over the remaining life of the asset. For transactions that occurred prior to January 1, 2013, the law provided an election whereby the transferee could make the basis adjustment for any deductions foregone by the transferor. However, this allowance does not help a taxpayer who had disposed of the asset or whose asset had no remaining useful life. This section remedies this situation by allowing a taxpayer to deduct the remaining bonus depreciation on the 2013 tax return.

Personal income tax deductions

Section 2.2 does the following two things.

First, it clarifies that a person who is not eligible for a federal standard deduction is not eligible for a State standard deduction. North Carolina follows the federal law concerning an individual's eligibility for a standard deduction. The tax reform legislation inadvertently failed to follow this practice. Under federal law, the following individuals are not eligible for a standard deduction:

- A married individual filing a separate return where either spouse itemizes deductions.
- A nonresident alien individual. A resident alien is a person who meets either the "green card test" or the "substantial presence test".
- An individual making a return for a period of less than 12 months on account of a change in the person's annual accounting period.
- An estate or trust, common trust fund, or partnership.

Second, it clarifies the application of the $20,000 deduction for mortgage interest expenses paid and property taxes paid on real estate. S.L. 2013-316 limited the federally allowed itemized deductions for mortgage interest expenses paid and property taxes paid on real estate at $20,000. The intent of the legislation was for the $20,000 cap to apply to the

cumulative deduction for a married couple, regardless of how the couple files a return. At the request of the Department of Revenue, this section clarifies this intent.

This section is effective for taxable years beginning on or after January 1, 2014.

Income tax rate applicable to estates

Section 2.3 updates the statutory references in G.S. 105 160.2 which imposes income tax on estates and trusts. Estates and trusts generally receive the same modifications to taxable income and tax rates as single individuals. House Bill 998, S.L. 2013 316, moved the statutes allowing modifications to North Carolina taxable income and setting the tax rate.
This section is effective for taxable years beginning on or after January 1, 2014.

PART III: AGRICULTURAL EXEMPTION CERTIFICATE

SUMMARY: Part III of the Omnibus Tax Law Changes bill gives guidance to the farming community and the Department of Revenue as to the administration of the income threshold a person must meet to qualify for a sales tax agricultural exemption certificate. It also allows a three-year income averaging to address issues of income volatility in farming operations and a conditional exemption certificate for new farmers.

CURRENT LAW: In S.L. 2013-316, the General Assembly imposed an income threshold a person must meet to qualify for a sales tax agricultural exemption certificate. Effective July 1, 2014, a person does not qualify for an agricultural exemption certificate unless the person has an annual gross income for the preceding taxable year[7] of at least $10,000 from farming operations. For federal income tax purposes, gross income from farming includes sales of agricultural products, cooperative distributions, agricultural program payments, and crop insurance and federal disaster payments. It appears five other states impose an income requirement to qualify for a sales tax agricultural exemption: Connecticut, Georgia, Rhode Island, Tennessee, and Washington. The income limit in these states varies from $1,000 in Tennessee to $10,000 in Washington. Four of those states have conditional exemption certificates for new farmers.

An agricultural exemption certificate allows a person to purchase the following items for farming operations without paying sales tax on those items: fuel; electricity; commercial fertilizer, lime, land plaster, plastic mulch, plant bed covers, potting soil, baler twine, and seeds; farm machinery; attachments and repair parts for farm machinery; containers used in farm production, packaging, and transporting; grain, feed, or soybean storage facilities; substances for use on animals and plants, such as vaccines, insecticides, defoliants, and plant growth regulators; baby chicks; facilities used for housing, raising, or feeding animals; and bulk tobacco barns and parts and accessories for those barns.

A person who qualifies for an exemption certificate must apply to the Department. A certificate is valid until it is cancelled or revoked. An exemption certificate authorizes the retailer to sell an item to the holder and either collect tax at a preferential rate or not collect tax on the sale, as appropriate. A retailer does not need to obtain a certificate for each purchase if the retailer has a blanket certificate from a purchaser with which the retailer has a recurring business relationship. A person who purchases an item with a

[7] The statute currently says "calendar year". The Department has requested that the term be changed to "taxable year". The bill draft makes this change.

certificate is liable for any tax due on the sale if the Department determines the person is not eligible for the certificate. The statute does not place an affirmative duty on the holder of a certificate to notify the Department if the person no longer qualifies for it.

BILL ANALYSIS: Part III of the bill answers questions the farming community has posed concerning the implementation of the gross income requirements:

- Administration. – The bill clearly states that a person may not use an agricultural exemption certificate after July 1, 2014, unless the person meets the income requirements and that a person who no longer qualifies for the certificate is liable for any tax due. A qualifying farmer must apply to the Department for a new exemption certificate. A retailer may continue to rely upon a blanket certificate until October 1, 2014.

- Application for Certificate. – Neither the law enacted last year nor this bill changes the current administration of exemption certificates. However, the bill does impose an affirmative duty on a person who has an exemption certificate to notify the Department whenever the person no longer qualifies for it and to give notice to any seller that may rely on it. The affirmative duty applies to all holders of a certificate, not just farmers. This affirmative duty is similar to the one imposed on taxpayers who no longer qualify for preferential property tax treatment. The farming community is familiar with this requirement as part of the present use value property tax exemption program.

- Liability for Tax Due. – The bill affirmatively states that anyone who purchases an item under an exemption certificate is liable for the tax due on the purchase if the Department determines that the person is not eligible for the certificate or that the item purchased does not qualify for exemption under the certificate.

- Income Volatility. – The bill makes a substantive change to the income threshold at the request of the farming community to address volatility in farming income and to prevent a person from moving into and out of the exemption annually. To obtain a certificate, a person must have $10,000 of gross income from farming operations during the preceding taxable year or an average of $10,000 of gross income from farming operations for the three preceding taxable years. A farmer no longer qualifies for the exemption certificate when the farmer fails to meet the income threshold for three consecutive years. The Farm Bureau expressed concerns for certain types of farming operations that may not produce income on an annual basis, such as cattle breeders and timber operations.

- New Farmers.[8] – The bill provides that a person who does not meet the income requirement to qualify for an exemption certificate may apply to the Department of Revenue for a conditional exemption certificate by certifying an intention to engage in farming operations and filing an income tax return that reflects income and expenses from farming operations.[9] A conditional exemption

[8] This provision was added to the bill by a Senate floor amendment.

[9] Form Schedule F is the IRS form a person uses to report farming activities if the person is engaged in the business of farming. A person who does not engage in farming activities for profit, i,e, farming is a hobby activity, does not use a Schedule F. The presumption is that the farming activity must

certificate is valid for three years, so long as the person provides the Department of copies of a tax return demonstrating activity from farming operations for each year the certificate is issued. A conditional certificate may not be extended or renewed; and a new one may not be issued for at least 15 years. A person who fails to meet the requirements of a conditional exemption certificate is liable for any taxes for which an exemption was claimed, together with interest and penalties from the date of the original purchase.

EFFECTIVE DATE: The bill would become effective July 1, 2014, and apply to purchases made on or after that date.

BACKGROUND: There are currently 49,437 agricultural exemption certificates outstanding. Last year the Department issued 2,185 new certificates and it issued 2,253 certificates in 2012. Here are some statistics from the 2012 USDA Census of Agriculture:

	2012	**2007**
Total NC Farms	50,218	52,913
NC Farms < $10,000 in sales	31,492	34,276
NC Farms > $10,000 in sales	18,726	18,637
NC Farms < $10,000 in sales & government payments	30,960	33,741
NC Farms > $10,000 in sales & government payments	19,258	19,172

PART IV: PREPAID MEAL PLANS

SUMMARY: Part IV of the Omnibus Tax Law Changes bill addresses sales tax issues related to the repeal of the sales tax exemption for meals served to students in dining rooms of regularly operated educational institutions.

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produce a profit in at least 3 of the last 5 years, including the current year, to be considered a business.

CURRENT LAW: S.L. 2013-316 repealed the exemption for meals served to students in dining rooms of regularly operated by educational institutions, effective January 1, 2014. In practice, meals are not always sold directly. Today, educational institutions sell a variety of meal plans that offer choices between a specific number of "meal swipes" and "food dollars". The meal swipes are part of a prepaid meal plan that entitles the student to a predetermined number of meals. The cost applies regardless of whether or not the student consumes the meals. The food dollars are part of a declining card balance, much like a debit card, that may be used in on-campus facilities for a variety of purchases as well as with participating privately-owned facilities. The meal swipes are problematic to tax on a transactional basis because the gross receipts paid for the meal swipes applies regardless of whether or not the meals are consumed. In practice, few institutions operate their dining halls; instead, they contract with third party vendors to prepare the meals and operate the dining halls.

BILL ANALYSIS: Part IV of the bill addresses questions and administrative issues taxpayers and the Department of Revenue have encountered with the taxation of food and prepared food sold to students in colleges and universities.

Subsection	Explanation
(a)	Defines a prepaid meal plan to be a plan offered by an institution of higher education that entitled a person to food or prepared food, that is billed or paid for in advance, and that provides for predetermined units or unlimited access to food or prepared food but does not include a dollar value that declines with use. The definition limits the applicability to those transactions that benefited from the sales tax exemption repealed in S.L. 2013-316. It does not apply to the part of a meal plan that is based on a declining card balance, such as the food dollars, because those transactions are taxed at the time they are made. By applying the tax to the gross receipts derived from the plan, it is clear that that the tax is based upon the amount paid for the plan and not upon the use of the plan.
(b)	Imposes a sales tax at the general rate upon the sales price of or gross receipts derived from a prepaid paid meal plan. The local sales tax also applies to an item taxed by the State at the general sales tax rate.
(c)	Sources the local sales tax revenue to the county where the school is located.
(d)	Addresses how to tax a transaction where one amount is paid for a taxable item (prepaid meal plan; meals) and a nontaxable item (declining card balance; tuition; room). In that instance, tax applies to the allocated price of the prepaid meal plan. The tax applies to items purchased with a dollar value that declines with use as the dollar value is used. Tuition and room are not subject to sales tax.
(e)	This subsection does two different things: Clarifies that the remaining sales tax exemption for meals sold in elementary and secondary schools applies to any school regulated under Chapter 115C. Public K-12 schools, private K-12 schools, regional schools, and home schools are regulated under Chapter 115C. Residential schools

	are regulated elsewhere.[10] The bill removes the words "not for profit" because meals provided to K-12 students take many forms. This change ensures that the tax treatment for meals sold in elementary and secondary schools remains unchanged until the General Assembly makes a policy choice to tax them differently. Exempts food and prepared food used to prepare a meal for consumption under a prepaid meal plan from sales tax because this transaction is analogous to a sale for resale.
(f)	Provides schools with an option for reporting and remitting sale tax revenue derived from a prepaid meal plan to the State. The option allows the institution to contract with the food service contractor to be liable for the collection and remittance of the tax. At least one university has a contract with its food service contractor to remit the tax to the State on behalf of the university. The university remains the retailer under the sales tax laws because it is the person making, offering, and soliciting the sale of the prepaid meal plan. The tax will apply to the gross receipts the university derives from the prepaid meal plan; this amount includes the amount charged the university by the food service contractor and any other expenses included by the university in the price it charges for the prepaid meal plan. Under this option, the retailer (institution) would send the tax receipts collected to the food service contractor and the food service contractor would send the receipts, along with other tax receipts, to the Department of Revenue.

EFFECTIVE DATE: This act is effective when it becomes law and applies to gross receipts derived from a prepaid meal plan sold or billed on or after July 1, 2014.

PART V: ADMISSIONS

SUMMARY: Part V of S.L. 2014-3 addresses sales tax issues associated with the expansion of the sales tax base to include gross receipts derived from admissions to a live event, a movie, and other attractions for which an admission is charged.

CURRENT LAW: S.L. 2013-316 changed the taxation of live events and movies from a 3% gross receipts privilege tax to a State and local sales tax. The two taxes differ in that the gross receipts tax was imposed upon the person engaged in providing the event; it was not designed to be passed directly onto the consumer. The sales tax is imposed upon the retailer, but it is intended to be passed onto the purchaser and borne by the purchaser instead of the retailer.[11] The payment of the tax is considered a debt from the purchaser to the retailer until it is paid. A retailer is considered to act as a trustee on behalf of the State when it collects tax from the purchaser. The tax should be stated and charged separately unless the retailer displays a statement indicating the sales price includes the tax.

[10] The School of Math and Science and the School of the Arts are part of the UNC system.
[11] G.S. 105-164.7.

The gross receipts tax was payable monthly and the return covered the gross receipts received during the previous month.[12] The sales tax is due quarterly, monthly, or bi-monthly depending upon the tax liability of the retailer.[13] The administration of the sales tax is more defined to ensure uniform tax treatment. North Carolina is also a member state in the Streamlined Sales Tax Agreement. One of the purposes of this Agreement is to ensure uniformity among the participating states so the tax may be more efficiently administered by retailers who conduct business in more than one state.

BILL ANALYSIS: This Part makes the following changes to the laws applicable to sales tax on the gross receipts derived from an admission charge:

Subsection	Explanation
(a)	Clarifies that for purposes of the imposition of sales tax, the term "gross receipts" has the same meaning as the term "sales price". "Sales price" is defined to be the total amount or consideration for which tangible personal property, digital property, or services are sold, leased, or rented. This subsection also removes the details concerning how amusements are taxed and moves those provisions to a new statute in subsection (c) of this section. The imposition of the tax itself remains in G.S. 105-164.4.
(b)	Sources the local sales tax revenue derived from admission charges to the location where admission to the entertainment activity may be gained. When the location where admission may be gained is not known at the time of the transaction, the general sourcing principles of G.S. 105-164.4B(a) apply: the business location where the product is received; the location where the product is received; the location indicated by the address of the purchaser.
(c)	Creates a new statute to address the taxation of admission charges: • It defines an "admission charge" as the gross receipts derived for the right to attend an entertainment activity. An entertainment activity is defined as a live performance, a movie, a museum or similar attraction and a guided tour of that attraction. The act does not expand the definition the types of entertainment subject to the tax. The policy decision of what types of entertainment to include in the sales tax base was made in S.L. 2013-316. It defines an "amenity" as a feature that increase the value of an entertainment activity by giving the person access to items that are not subject to sales tax and that are not available with purchase of admission to the event without the feature. Lastly, it defines a facilitator. The law enacted last session did not define "admission charge" or "amenity". A definition of "facilitator" is needed to accomplish the administration of the tax as provided in this subsection. • It provides that a retailer is the operator of the venue where the entertainment activity occurs. In practice, admission to an entertainment

[12] By practice, some taxpayers remitted the gross receipts tax at the time the event occurred.
[13] G.S. 105-164.16.

	event may often be obtained at multiple places from multiple people. To accommodate this business practice, the act does the following: ○ Provides that a person who provides the entertainment and received admission charges directly from purchaser is a retailer. This provision would allow a person, such as the symphony, that leases space to perform to be a retailer. In this example, the venue would also be a retailer if the venue also sells admission to the symphony event. ○ Provides the operator of the venue and a facilitator may have a contractual agreement for dual reporting. Dual remittance will allow the operator of the venue to remit the tax on the admission charge and the facilitator to remit the tax on any other charges the facilitator imposed that were necessary for the purchaser to pay to complete the transaction. • It defines a facilitator as a person who accepts payment of an admission charge to an entertainment activity and is not the operator of the venue where the entertainment activity occurs. It requires the facilitator to report to the retailer the admission charge a person pays to the facilitator and to send to the operator the tax due on the gross receipts derived from an admission charge no later than 10 days after the end of each calendar month. A facilitator that does not send this amount to the retailer is liable for the tax due. These requirements are considered terms of the contract between the retailer and the facilitator. These provisions are the same as the provisions applicable to facilitators who accept payment from a consumer for accommodations. • It clarifies what transactions are not subject to the tax: ○ Amounts paid to participate in sporting events. ○ Tuition, registration, or any other charge to attend an instructional or educational seminar, workshop, or conference. ○ A political contribution. ○ A charge for lifetime seat rights, leases, or rental of a suite or box, provided the charge is separately stated. ○ An amount paid solely for transportation. • It clarifies the following exemptions from the tax: ○ The portion of a membership charge that is deductible as a charitable contribution under federal income tax laws. ○ A donation that is deductible as a charitable contribution under federal income tax laws. ○ Charges for an amenity. • It changes the events that are exempt from the tax to the following:

	○ An event sponsored by an elementary or secondary school. ○ An event sponsored by a nonprofit that is exempt from income tax if all of the following conditions are met: the entire proceeds of the event are used exclusively for the entity's nonprofit purpose; the entity does not compensate members or individuals; the entity does not compensate any person for participating in the event, performing in the event, placing in the event, or producing the event. • It repeals the following exemptions, thus subjecting the gross receipts derived from an admission charge to that event to sales tax, effective January 1, 2015: ○ An agricultural fair. ○ Up to two activities a year sponsored by a nonprofit.[14] ○ A State attraction.
(d)	Makes a conforming change to the exemption statute. This subsection becomes effective January 1, 2015.
(e)	Clarifies that long-standing exemptions applicable to tangible personal property sold by nonprofit entities do not apply to gross receipts derived from an admission charge to an entertainment activity.
(f)	Provides that the gross receipts derived from admission to a live event purchased on or after January 1, 2015, will be taxable under the sales tax statutes, regardless of the date of the initial sale of tickets. S.L. 2013-315 provided a transitional period. Under S.L. 2013-316, the gross receipts for a live event where the initial sale of admission occurred on or before January 1, 2014, are taxable under the old 3% gross receipts privilege tax statutes.

EFFECTIVE DATE: Except as otherwise stated in the summary, the provisions in this Part become effective January 1, 2015.

PART VI: SERVICE CONTRACTS

SUMMARY: Part VI of the Omnibus Tax Law Changes bill addresses sales tax issues associated with the expansion of the sales tax base to include the sales price of a service contract.

CURRENT LAW: S.L. 2013-316 expanded the sales tax base to include the sales price of a service contract. A service contract is defined as a warranty agreement, a maintenance agreement, a repair contract, or a similar agreement or contract by which the seller agrees to maintain or repair tangible personal property. The act exempted from the tax items

[14] A subcommittee of the Revenue Laws Study Committee recommended that similar events be taxed similarly, regardless of the entity providing the event. This policy decision led to the repeal of these exemptions. The subcommittee also found that the exemptions caused confusion re: what was a State attraction and what two events could be exempt. This confusion should be eliminated by the repeal of these exemptions.

exempt from sales tax, other than motor vehicles; network assets on utility owned lands and on right-of-ways or easements; and items purchased by a professional motorsports racing team for which the team may receive a sales tax refund. The act also exempted an item used to maintain or repair tangible personal property pursuant to a service contract if the purchaser of the contract is not charged for the item.

BILL ANALYSIS: This Part makes the following changes to the law applicable to the sales tax on service contracts:

Subsection	Explanation
(a)	Changes the definition of a service contract to alleviate confusion about who must provide the work under the service contract for the contract to be taxable. In practice, service contracts are often sold by a seller on behalf of the person obligated to provide the service. This subsection changes the definition of a service contract to be a contract where the obligor under the contract agrees to maintain or repair tangible personal property or a motor vehicle.
(b)	Clarifies in the sales tax imposition statute that the tax applies to the sales price of or the gross receipts derived from a service contract.
(c)	Creates a new statute to address the sales tax on service contracts: • It clarifies that the local sales tax revenue from a service contract are sourced in accordance with the general sourcing principles of G.S. 105-164.4B. • It defines a retailer as the obligor when the obligor sells the service contract to the purchaser at retail. If the service contract is sold to the purchaser by a facilitator, the facilitator is the retailer unless the facilitator and the obligor have a contractual agreement that the obligor will be liable for payment of the tax. In this instance, the facilitator must send the retailer the tax due on the sales price of or the gross receipts derived from the service contract within 10 days after the end of each calendar month. A facilitator that does not send the retailer the sales tax due is liable for the tax. A facilitator is defined as a person who contracts with an obligor to market the service contract and accept payment for the contract. These provisions are substantially the same as the provisions that apply to a facilitator who accepts payment of sales tax on accommodations. • It moves the exemptions from G.S. 105-164.13 and places them in the newly created statute. • It adds an exemption for items subject to tax under Article 5F, the 1% excise tax on mill machinery and other similar transactions. • It clarifies that the tax does not apply to service contract for items sold at retail that become part of real property unless the service contract is sold at the same time as the item of tangible personal property covered in the contract. The tax does not apply to security or similar monitoring contracts for real property or to a renewal of a service contract where the tangible personal property covered by the contract

	becomes part of or affixed to real property prior to the effective date of the renewal. • It requires a retailer to report the sales price of or gross receipts derived from a service contract on an accrual basis, so that the receipts are recognized when the transaction occurs rather than when payment is received. Some service contracts are financed over time. This provision clarifies that the sales tax is due at the time of the retail sale and not at the time of the periodic payments.
(d)	Creates a new statute for refunds of sales tax paid on a rescinded sale or a cancelled service. Historically, retailers have provided purchasers a refund of the sales tax paid on tangible personal property that is returned to the retailer for a refund. The retailer is allowed to reduce taxable receipts on the subsequent sales tax return by the taxable amount of the refund for the period in which the refund occurs or may request a refund of an overpayment of tax. This section codifies this current practice. The new statute creates a process to allow a purchaser of a service contract a refund of the sales tax paid. The process is different for a service contract because often the refund is provided by a person who was not the retailer that sold the service contract. This situation becomes more uncertain when the service contract is for a motor vehicle. Under the bill, if the purchaser receives a refund on any portion of the sales price of a service contract purchased from the retailer who collected the sales tax on the retail sale, then the general provisions applicable to rescinded sales apply. If the purchaser receives a refund from anyone else and the amount refunded does not include the sales tax paid on the refundable amount, then the purchaser may apply directly to the Department of Revenue for a refund. An application for a refund must be supported by documentation on the taxable amount of the service contract refunded to the purchaser and it must be filed within 30 days after the refund is received. A sales tax refund filed after the due date is barred.
(e)	Makes a conforming change.
(f)	Clarifies the exemption applicable to an item used to maintain or repair tangible personal property pursuant to a service contract. The exemption does not apply to an item used to maintain or repair mill machinery and other items taxable under Article 5F, since the service contract applicable to this tangible personal property is not subject to tax. The exemption does not apply to a tool, equipment, or similar item of tangible personal property used to complete the maintenance or repair unless the item becomes a component or repair part of the item for which the service contract is sold. For example, the exemption does not apply to the hammer and screwdriver used to do the work under a service contract.
(g)	Clarifies that the gross receipts derived from a service contract for a motor vehicle are not subject to the highway use tax.
(h) (i)	Conforming changes to the local sales tax statutes.

EFFECTIVE DATE: This Part becomes effective October 1, 2014, and applies to gross receipts derived from a service contract sold at retail on or after that date.

PART VII: RETAILER-CONTRACTORS

SUMMARY: Part VII of this bill addresses the applicability of the sales tax laws to retailer-contractors, such as the major home improvement stores, when they are engaged in a performance contract rather than a retail sale. Specifically, a retailer-contractor would be considered the consumer of the items or materials they furnish and install or apply to real property to the extent the item becomes part of the real property. As the consumer of those items, the retailer-contractor would be responsible for payment of the tax rather than the customer. This provision becomes effective January 1, 2015.

CURRENT LAW: Under current law, retailers are required to collect and remit sales tax on retail sales of tangible personal property. Under a performance contract, the contractor agrees to furnish the necessary materials, labor, and expertise to accomplish the job; it is not a contract for the sale of specific items. Contractors are deemed to be the consumers or end users of the tangible personal property they use in fulfilling performance contracts and are liable for the tax. However, when a customer purchases an item from a home improvement store and enters into a contract with the store for the installation of the item in their home, it is not always clear whether that transaction is a retail sale plus installation or a performance contract.

The statutes provide little guidance as to what the correct interpretation is. They do not define "contractor" or "performance contract" or speak to when the installation of tangible personal property constitutes a real property improvement. The definition of "sale" refers to when title or possession is transferred. When a contractor permanently affixes an item of tangible personal property to real estate, title and possession typically transfer upon installation. However, once the item is permanently affixed to real property, general principles of real estate law provide that the item is no longer tangible personal property but has transformed into a real property fixture. Therefore, when a homeowner obtains title or possession to the property, the property is real estate and, therefore, one could argue no retail sale of tangible personal property has occurred. Adding further confusion to the mix, North Carolina's definition of "retailer" includes the business of installing tangible personal property regardless of whether it is permanently affixed to real property. This definition suggests that all contractors are also retailers, which conflicts with other principles at play.

The Department has developed guidance on this issue through its technical bulletins, and the tax treatment is ultimately determined by looking at a number of factors, such as whether an item is sold with an installation agreement, the tenor of the agreement, if there is one, whether an item is pre-fabricated, whether an item is built on-site, and whether a specific quantity is stated in the agreement. Determining the tax consequences involves a complex and fact-specific analysis. Over the years, the guidance has been inconsistent and, at the very least, confusing. For example, the sale and installation the same item, such as carpet, may have different tax treatment depending on who the seller is and how the transaction is structured. Also, transactions that seem to be similar in nature, such as the installation of countertops and cabinets, are treated differently as well.

For several years, the Department has sought clarification from the General Assembly on this issue. The Revenue Laws Study Committee first studied it in 2012, with no recommendation, and again in 2013 recommending this legislation.

BILL ANALYSIS: This Part provides that the general rate of tax applies to the sales price of tangible personal property sold to a real property contractor when that property is used by the contractor for the improvement, alteration, or repair of real property and the item becomes part of the real property. The Part defines the term "retailer-contractor" as an entity that acts as a retailer when it sells tangible personal property and as a real property contractor when it performs real property contracts. The sales tax provisions applicable to a real property contractor would apply to a retailer-contractor when it is acting as a real property contractor. Retailer-contractors may continue to make tax-exempt purchases of materials, as they do now, but would accrue and pay the tax once the items are withdrawn from inventory and used in the performance of a real estate improvement contract. If the retailer-contractor uses a subcontractor to perform the installation, then the subcontractor would pay the tax on any items the subcontractor purchases in fulfilling the contract. However, in accordance with existing use tax principles, the retailer-contractor and the subcontractor would be jointly and severally liable for the tax.

EFFECTIVE DATE: This Part becomes effective January 1, 2015, and applies to sales on or after that date and contracts entered into on or after that date.

BACKGROUND: This issue drew particular attention in 2009 when newspaper reports revealed a long-running dispute between Lowe's and the Department of Revenue on the application of the law in this area. The report indicated that Lowe's was not collecting sales tax when it sold and subsequently installed items such as cabinets, flooring, and countertops. The Department's position is that these transactions are retail sales plus installation and that Lowe's should be collecting sales tax on the purchases but not the installation charges as long as those charges are separately stated on the customer's invoice. Lowe's position is that these transactions are performance contracts and, therefore, they are only required to pay the use tax because they are the user or consumer of that property and that the cost is factored into the "contract price" ultimately paid by the customer, but it is not a separately stated cost.

PART VIII: OTHER SALES TAX CHANGES

SUMMARY: Part VIII makes various sales tax changes.

CURRENT LAW, BILL ANALYSIS, AND EFFECTIVE DATE:

Section	Explanation and Effective Date
8.1	This section moves the substance of the law imposing the State sales tax on accommodations to a new statutory section for stylistic purposes. The only substantive change provides that a private residence or cottage rented for fewer than 15 days that is listed with a real estate broker or agent is subject to sales tax and occupancy tax. Beginning in 1984, the Department of Revenue interpreted the private residence exemption to apply only if the residence was not listed with a real estate agent. A 1988 memo by an Associate Attorney General supported this interpretation. In 2012, the Department changed its interpretation and issued an Important Notice indicating that the sales tax

	exemption applied to a private residence rented for fewer than 15 days regardless of whether it was listed with a real estate agent. The current law states that "*The tax does not apply to a private residence or cottage that is rented for fewer than 15 days in a calendar year…*", but it goes on to state that "*A person who, by written contract, agrees to be the rental agent for the provider of an accommodation is considered a retailer under this Article and is liable for the tax*." The Department has requested that language be added to the statute that is consistent with its pre-2012 interpretation. This change would impact the application of occupancy tax as well because G.S. 155A-155 and 160A-215 provide that "*the room occupancy tax applies to the same gross receipts as the State sales tax on accommodations and is calculated in the same manner as that tax*." This section would become effective June 1, 2014, and apply to private residences occupied as a transient accommodation on or after that date even if the accommodation was reserved or paid for prior to the effective date.
8.2	This section disallows a sales tax refund for sales tax paid on video programming and piped natural gas. Historically, the State sales tax refunds allowed to nonprofits and local governments has not applied to sales tax paid on utilities. Prior to 1995, when piped natural gas was subject to sales tax, piped natural gas was included in the list of utilities for which a sales tax refund was not allowed. Last session, when the General Assembly made the policy decision to return piped natural gas to the sales tax base, this conforming change was not considered or made. Likewise, when the General Assembly made the policy decision to begin taxing video programming as a utility, a conforming change to the refund statutes was not considered or made. This section treats utilities that are taxed by the State at the combined general rate the same. This section became effective July 1, 2014, and applies to purchases occurring on or after that date.
8.3	Subsection (a) repeals the sales tax exemption for sales from vending machines of one cent per sale. The provision is obsolete. S.L. 2013-316 removed the sales tax exemption applicable to newspapers sold by street vendors, newspaper carriers, and vending machines. The intent was to tax all newspapers at the State and local sales tax rate. However, G.S. 105-164.13(50) exempts 50% of the sales price of items sold through a coin-operated vending machine from sales tax. To maintain the intent of the 2013 tax law change, subsection (b) provides that the sales tax exemption applicable to 50% of the sales price of items sold through a vending machine does not apply to newspapers. The law currently excludes tobacco products sold through vending machines from this 50% exemption. This section became effective October 1, 2014, and applies to sales made on or after that date.

PART IX: EXCISE TAX CHANGES

SUMMARY: Part IX makes various changes to the excise tax statutes, as requested by the Excise Tax Division of the Department of Revenue.

CURRENT LAW, BILL ANALYSIS, AND EFFECTIVE DATE:

Section	Explanation	Effective Date
9.1	Subsection (c) of this section applies to the excise tax on alcohol. It would allow a wholesaler or importer of malt beverages and wine to provide security to the Secretary in the form of a letter of credit as an alternative to a bond. This form of security is consistent with what is currently allowed under the excise tax statutes for motor fuels and tobacco products. This subsection also removes the option of a taxpayer providing security in the form of a bond based upon obligations of a governmental unit. This option has not been used in recent memory and is not a form of collateral allowed in other tax schedules. In the few instances where it has been used, the Department's experience has shown that the bonds are often rolled over into a personal CD when the bond matures rather than another governmental bond. Subsections (a) and (b) of this section modernize the statutes and clarify that the letter of credit must be issued by a bank acceptable to the Secretary and available to the State as a beneficiary.	When it becomes law
9.2	This section would allow a wholesale dealer or retail dealer of other tobacco products to provide the Department a manufacturer's tax affidavit in lieu of a notarized tax affidavit as supporting documentation for a tax refund. A dealer that has stale or unsalable tobacco products upon which the tax has been paid is allowed a refund of that amount. The majority of states allow a dealer to use manufacturer tax affidavits as supporting documentation. The allowance of a written certification from the manufacturer signed under perjury of law does not lessen the accountability of the taxpayer and it expedites the administration of the refund. The change in the statute has been requested by taxpayers.[15]	
9.3	This section amends the tax secrecy provisions as follows: • To allow the Department to furnish a data clearinghouse the information required to be released in accordance with the State's agreement under the December 2012 Term Sheet Settlement, as finalized by the State in the	When it becomes law

[15] U.S. Smokeless Tobacco Brands operates a secure website that allows distributors to access affidavits and credit memos for their returns. Each affidavit includes an accurate list of product eligible for return in a state along with an electronically signed statement.

	NPM Adjustment Settlement Agreement, concerning annual tobacco product sales by a nonparticipating manufacturer. • To allow the Department to share information with a person who provides a surety bond or irrevocable letter of credit on behalf of a taxpayer if the information is necessary for the Department to collect on the bond or letter of credit in the event the taxpayer does not comply with the tax laws.	
9.4	This section allows the Secretary of Revenue to delegate the authority to hold hearings. Under administrative practice, this authority has been delegated to a staff attorney.	When it becomes law
9.5	This section clarifies that the tax on motor carriers applies to both intrastate motor carriers and to interstate motor carriers. It also updates the reference to the International Fuel Tax Agreement from June 1, 2010, to July 1, 2013. The update in the reference does not make any substantive changes to the tax laws concerning motor carriers.	When it becomes law
9.6 9.10	Section 9.6 clarifies that local sales tax is due on motor fuel for which a refund of the per gallon excise tax is allowed. Under current law, the State sales tax is deducted from any amount of excise tax refunded. This section clarifies that the local sales tax revenue is also deducted from any amount of excise tax refunded. Section 9.10 clarifies the amount of local sales tax to be deducted from a refund of excise tax paid.	When it becomes law
9.7	This section imposes the excise tax on B100 biodiesel fuel, thus taxing all biodiesel fuel the same. B100 is not subject to federal excise tax, and as such was not subject to the State excise tax under the prior law. B99.9 is subject to the State excise tax since it is a blended product. B100 is most commonly used as a motor fuel. This section became effective October 1, 2014.	October 1, 2014
9.8	This section allows the Secretary to waive or reduce civil penalties imposed under the motor fuel tax statutes under the Department's penalty waiver policy used for other tax schedules. Under prior law, a person assessed a civil penalty under the motor fuel tax laws had to pay the penalty at the time it was assessed and file a request for a Departmental review of the penalty. Under the change made by this section, the penalty is not automatically payable upon assessment. The administrative process for waiving or reducing the penalty is made much more simple and less time consuming. Although a taxpayer must go through the review process for the waiver or reduction of a penalty, the guidelines used to make the	When it becomes law

	decision are the same guidelines currently applied through the penalty waiver policy.	
9.9	This section clarifies that a shipping document required by the vessel transporting motor fuel is intended to provide permanent information. Under current law, if the document is issued by a refiner or a terminal operator, the document must be machine printed. That requirement does not apply for a tank wagon importer. A tank wagon importer is a person who imports motor fuel from a terminal or bulk plant in another state and transports the fuel only by means of a tank wagon. A tank wagon is a truck designed to carry at least 1,000 gallons of motor fuel but is not a transport truck. Motor fuel investigators have found shipping documents to be notes contained on a "grease board" or chalk board or other type of device that can be erased. This section became effective October 1, 2014.	October 1, 2014
9.10	Removes obsolete references to the privilege tax.	

EFFECTIVE DATE: Except as otherwise provided, this Part became effective when it became law on May 29, 2014.

PART X: TAX LAW COMPLIANCE CHANGES

SUMMARY: Part X of S.L. 2014-3, requires filing all State tax returns and paying all State taxes to receive and hold an ABC permit. Part X also authorizes the Department of Revenue to use $500,000 (currently, $150,000) from the collection assistance fee account to contract for taxpayer locater services. However, Part XXVI of Senate Bill 744, S.L. 2014-100, reduced the authorization from $500,000 to $350,000.

CURRENT LAW: G.S. 18B-900 lists the following requirements to receive and hold an ABC permit:

- Be at least 21 years old (19 years old for managers selling only beer and wine).
- Be a NC resident unless the out-of-state person is not responsible for operations.
- Not have been convicted of a felony within 3 years or had citizenship restored.
- Not have been convicted of an alcoholic beverage offense within 2 years.
- Not have been convicted of a misdemeanor controlled substance offense within 2 years.
- Not have had an ABC permit revoked within 3 years except failures to pay registration fee.
- Not have an unsatisfied judgment for injury caused by sales to underage persons.

The requirements under G.S. 18B-900 apply to each of the following persons:

- Owner of a sole proprietorship.
- Managers for a corporation.
- Members of a general partnership.
- General partners in a limited partnership.
- Managers and any members with 25% interest in a limited liability company.
- Each officer, director, and owner of 25% of a corporation.

G.S. 18C-141 prohibits the Director of the North Carolina State Lottery Commission from recommending lottery game retailers to the Commission who are not current in filing all State tax returns and paying all State taxes.

G.S. 105-230 suspends the charter of any corporation or a limited liability company that fails to file any tax return or pay any tax. Any act performed or attempted to be performed during the period of suspension is invalid and of no effect unless the charter is reinstated after filing and paying all taxes.

G.S. 105-243.1 imposes a 20% collection assistance fee on overdue tax debts after 90 days.[16] The collection assistance fee is credited to a special account and must be applied to the costs of collecting overdue tax debts.

BILL ANALYSIS:

Part X – Section 10.1.(a): This section adds a new requirement to G.S. 18B-900 that ABC permit applicants file and pay all State taxes. State taxes must be collectable and finally determined to be due for the tax to block an ABC application.

Procedurally, the ABC Commission will request the Department of Revenue check the State tax compliance status of persons. If the Department of Revenue reports to the ABC Commission that a person is not in State tax compliance, then the person cannot receive an ABC permit until the Department of Revenue reports to the ABC Commission that the person is in compliance. Taxpayers who enter into an installment payment agreement with the Department of Revenue are considered in compliance as long as the agreement is in force.

The requirement of State tax compliance operates like all ABC permit requirements under G.S. 18B-900 – applying to all persons listed in G.S. 18B-900(c) and applying continually to hold a permit. Four types of ABC permits may still be issued without State tax compliance: special occasion permit under G.S. 18B-1001(8), limited special occasion permit under G.S. 18B-1001(9), special one-time permit under G.S. 18B-1002, and salesman permit under G.S. 18B-1111.

Part X – Section 10.1.(b): The Administrative Procedure Act (Chapter 150B) does not apply to the ABC Commission's actions when determining State tax compliance and refusing to issue ABC permits.

Part X – Section 10.1.(c): The exchange of confidential taxpayer information between the Department of Revenue and the ABC Commission is authorized.

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[16] The Department of Revenue may not mail the collection assistance fee notice earlier than 60 days after the tax debt becomes collectible under G.S. 105-241.22. A collection assistance fee is imposed on an overdue tax debt that remains unpaid 30 days or more after the fee notice is mailed to the taxpayer.

Part X – Section 10.1.(d): This section authorizes the Department of Revenue to spend $500,000 annually on taxpayer locater services. The current authorization is $150,000. The source of the funds is the collection assistance fee imposed on overdue tax debts.

However, Part XXVI of Senate Bill 744, S.L. 2014-100, reduced the authorization from $500,000 to $350,000.

BACKGROUND:

Sections 10.1(a-c): The session law closely follows the statute (G.S. 18C-141) requiring lottery retailers to file and pay all State taxes. The ABC Commission and the NC Department of Revenue plan to check the State tax compliance of all new and renewing ABC permits starting May 1, 2015.

Section 10.1(d): The collection assistance fee provides funds to pay for the costs of collecting overdue tax debts which have included personnel at the Department of Revenue that collect taxes, locator services, and infrastructure projects. When attempting to collect overdue taxes, the Department of Revenue uses locator services through contracts with private data services to identify current addresses for taxpayers.

EFFECTIVE DATE: Sections 10(a-c) requiring tax compliance for ABC permits will be effective May 1, 2015. Section 10.1(d) increasing funding for locator services became effective May 29, 2014 when the section became law.

PART XI: PROPERTY TAX CHANGES

SUMMARY: Part XI provides for the central assessment of mobile telecommunications property.

CURRENT LAW & ANALYSIS: Under current law, the property is locally assessed by each county. The valuation of this property has become increasingly complex due largely to the rapidly changing technology in the industry and to the frequent acquisitions and mergers of wireless carriers. Central assessment by the Department would simplify the listing process for the industry and ensure uniformity of assessment among the counties. The intent is to shift the responsibility for conducting the valuations of this particular kind of property from the individual counties to the Department of Revenue without creating any "winners" or "losers" in terms of the values allocated to the counties. The change is supported by the mobile telecommunications industry, the Department of Revenue, and local governments.

The central assessment would apply to all of the tangible personal property of a mobile telecommunications company and would also include the cellular towers owned by such companies as well as the cellular towers owned by "tower aggregators." Real property owned or leased by a mobile telecommunications company or tower aggregator would continue to be assessed locally in each county. This section would become effective for taxable years beginning on and after July 1, 2015.

After the passage of H1050, the interested parties sought a clarifying change to this Part of the act. Under S.L. 2014-3, the allocation of the value among the counties in which the property is located is based only on original cost. Using original cost will have the effect of overinflating the value allocated to a particular county and decreasing the value allocated to other counties. A provision was added to the Revenue Laws Technical, Clarifying, and Administrative Changes bill (SB 763 and H1224) that would have provided that once the Department determines the value of the property, it will be allocated among the counties

based on where the property is located, but neither of those bills passed. This clarifying change will likely be sought during the 2015 Session.

PART XII: PRIVILEGE LICENSE TAX CHANGES

SUMMARY: Part XII of S.L. 2014-3 maintains the local privilege tax authority for one more year with two modifications: a city may not increase the tax on any business during that year, and it may not tax a business physically located outside the city's limits. Beginning July 1, 2015, both the city and county authority to levy a privilege license tax is repealed. This includes their authority to levy a privilege tax on low-level radioactive and hazardous waste facilities.

CURRENT LAW: Under current law, a city has the authority to levy a privilege tax on all trades, occupations, professions, businesses, and franchises carried on within the city, subject to certain limitations. These limitations range from outright prohibitions on certain businesses and professions to a cap on the amount of tax for other types of businesses. For example, cities are currently prohibited from levying a privilege license tax on certain professionals who are taxed at the State level, such as attorneys, physicians, engineers, real estate brokers, and home inspectors. Cities are also prohibited from taxing banks, private protective services, burglar alarm dealers, household appliance dealers, and office equipment dealers. Approximately 64 types of businesses are subject to a cap on the amount of tax that a city may impose. Examples of businesses whose rate is capped include: amusements, $25; collection agencies, $50; peddlers of farm products, $25; contractors, $10; restaurants, $42.50; barbershops & beauty parlors, $2.50 per person employed; firearms dealers, $50; auto dealers, $25.

Other than these specifically named prohibitions and caps, there is no statutory restriction on the amount of tax that may be charged. It may be in the form of a flat tax or a tax measured by gross receipts. Over 300 cities levy a privilege tax generating $62.2 million. It produces significant revenue for about seven cities: Charlotte, Raleigh, Greensboro, Durham, High Point, Lumberton, and Hickory.

Cities and counties may tax businesses that do not have a permanent physical location in the taxing jurisdiction as long as the business has a legally significant economic nexus with the city. Most businesses that fall into this category are service providers that provide services on a customer's property. This would include businesses like landscapers, plumbers, electricians, home inspectors, and appraisers. To the extent a business sends employees into a taxing jurisdiction to perform service or repair work, to deliver goods on a regular basis, to take orders for goods, or to receive payments, it is conducting business in that city and may be subject to the city's privilege tax.

Cities and counties also have authority under a separate statute to impose a privilege license tax on hazardous waste facilities or low-level radioactive waste facilities that are located within their limits. The rate is based on the additional costs incurred by the city or county from having such a facility in its jurisdiction to the extent compensation for the costs is not otherwise provided. These costs may include the loss of property tax revenues from the property on which the facility is located, the cost of providing additional emergency services, and the cost of monitoring air, surface water, groundwater, and other environmental media. There are approximately 42 of these facilities located inside city limits.

BILL ANALYSIS: Part XII of S.L. 2014-3 does three things:

- It reenacts G.S. 160A-211(a), the subsection that authorizes cities to levy a privilege license tax, which was inadvertently repealed by virtue of a drafting error in Section 58(b) of S.L. 2013-414. The reenactment is effective when it becomes law.
- It modifies the current authority in the following two ways:
    - For purposes of the 2014-2015 fiscal year, it limits a city's authority to tax only those businesses that are physically located within the city's limits. A business is not physically located within a city if its only presence in that city is through the performance of services or through the dispatch of employees to perform work, deliver goods, collect payments, or take orders. The intent of this provision is to tax only those businesses that have a physical location in the city, such as an office, a headquarters, a storefront, or other location from which the business directs and conducts its operations, or from which it holds itself out to the public as the place where the business is located.
    - It limits a city to the same privilege license tax schedule that was in place for the 2013-2014 fiscal year, meaning that a city may not increase any tax rate or tax amount for the 2014-2015 fiscal year; if a city did not have a privilege license tax in 2013-2014, it may not levy one in 2014-2015.
- Beginning July 1, 2015, both the county and city authority to levy a local privilege license tax are repealed. This includes the authority to levy a privilege tax on low-level radioactive and hazardous waste facilities. The city privilege tax generates a cumulative total of approximately $62 million; the county privilege tax, levied in only 37 counties, generates a total of less than $500,000. For many cities, the loss of revenue from the repeal of the current tax structure is overcome by the revenue it receives in local sales tax revenue from an expansion of the sales tax base under S.L. 2013-316[17] and from the greater collection of sales tax applicable to online purchases from the agreement of Amazon to collect and remit sales tax on purchases made through Amazon.[18]

PART XIII: LICENSE PLATE AGENT COMPENSATION

SUMMARY: Part XIII of S.L. 2014-3 sets the LPA transaction rate for the collection of property tax under the Tax & Tag Together program at the transitional rate of $1.06, clarifies the increased rate applies to all transactions where an LPA collects property tax as of July 1, 2014, and allows the retroactive portion of the fee increase to be paid out over a three month time period.

CURRENT LAW: The Division of Motor Vehicles (DMV) is required to ensure, as far as practicable and possible, that registration and registration renewals for motor vehicles may be issued through license plate agents (LPAs) located in every community across the State. DMV enters into commission contracts with individuals to perform this service. The local tag agents are compensated on a per transaction basis. The standard rate for a transaction is

[17] Approximately $10.9 million.
[18] Approximately $2.9 million.

$1.43. Unless otherwise provided, the performance of one or more transactions at the same time is considered a single transaction for purposes of compensation. Certain transactions are always considered separate transactions and allowed a different rate of compensation. The collection the highway use tax is considered a separate transaction and compensated at $1.27.

In September 2013, the State began implantation of a combined system for motor vehicle registration renewal and property tax collection. Under the new Tax & Tag Together program, the motor vehicle owner will receive one bill, and make one payment for both property taxes and vehicle registration renewal. The Tax & Tag Together program also provides for the issuance of a temporary registration plate if property taxes are not paid with the issuance of a new plate. A person may be issued a limited registration "T" sticker for the temporary registration plate.

S.L. 2013-372 provided increased compensation for LPAs new duties required under the Tax & Tag Together program. The collection of property taxes and the issuance of a "T" sticker" are recognized as separate transactions for the purpose of compensation. The transaction rate for the issuance of a "T" sticker was set at $1.27, effective July 1, 2013. The transaction rate for collecting property tax with registration renewals for the transitional period of the first six months of the Tax & Tag Together program was set at $1.06. The transaction rate after the first six months for both new registration and renewals was set at $0.71.

BILL ANALYSIS: Part XIII of S.L. 2014-3 sets the LPA transaction rate for the collection of property tax under the Tax & Tag Together program at the transitional rate of $1.06. The transitional rate will apply to the collection of property taxes with registration renewals for the entire 2013 fiscal year. The draft also clarifies the increased rate applies to all transactions where an LPA collects property tax, effective July 1, 2014, therefore, setting the transitional rate of $1.06 per transaction to all collections of property tax by LPAs for the 2014 fiscal year and thereafter.

Below is a chart that shows the recent changes in the compensation to LPAs, as well as the proposed increase:

	Transaction fee to LPAs for collection of:				
	Property tax with renewal		Property tax with new registration		Property tax with new registration and renewals
	July 2013 – March 2014	March 2014 – July 2014	July 2013 – March 2014	March 2014 – July 2014	July 2014 and thereafter
Prior to 2013-372	$0.48	$0.48	$0.48	$0.48	$0.48
2013-372	$1.06	$0.71	$0.71	$0.71	$0.71
2014-3	No change	$1.06	No change	No change	$1.06

The fee for property tax collection by LPAs for renewals that expire on or after March 1, 2014, was scheduled to decrease to $0.71. Part XIII of S.L. 2014-3 extended the transitional rate of $1.06 for the collection of property tax with registration renewals that expire on or after June 30, 2014. This Part directs DMV to calculate the difference in the payments made under the prior law and the act by September 1, 2014. The difference in

the two rates will be paid to LPAs by deducting the appropriate amount of the property tax revenues remitted to the counties. The payment to the LPAs and the corresponding reduction in the payments to the counties would be made in equal amounts over a three month period.

This Part also clarifies the increased fee for property tax collection applies to all transactions where a LPA collects property taxes, effective July 1, 2014.

DMV receives compensation from the counties for the duties it performs under the Tax & Tag Together program. A conforming change made in S.L. 2013-372 has been interpreted to provide DMV with an increase in the fee it receives for the collection of property tax to mirror the amount paid to LPAs. This Part maintains the increase in the fee to $0.71 for DMV provided in S.L. 2013-372, but does not provide DMV with the increase provided to LPAs. The fee provided to DMV will be the amount set in the Memorandum of Understanding (MOU) signed by the Department of Revenue and the Division of Motor Vehicles. Future MOUs can amend the transaction fee paid to DMV, but the fee cannot exceed the per transaction fee allowed for LPAs.

EFFECTIVE DATE: The portion of this Part related to the fee for registration renewals is effective March 1, 2014. The remainder of this Part is effective July 1, 2014.

PART XIV: TECHNICAL, CLARIFYING, AND ADMINISTRATIVE CHANGES

SUMMARY: Part XIV makes clarifying, conforming, and administrative changes to the various tax laws. Unless otherwise stated, this Part would become effective when it becomes law.

CURRENT LAW, BILL ANALYSIS, AND EFFECTIVE DATE:

Section	Explanation and Effective Date
14.1	This section corrects a cross reference.
14.2	This section replaces two outdated references with respect to qualifying for the major recycling facility tax credits. First, it replaces the term "enterprise tier one area" with the term "development tier one area." The current statute requires that, at the time the owner begins construction, the facility be located in an enterprise tier one area. The term "enterprise tier one area" was part of the Bill Lee tax credits, which expired in 2007. The current equivalent term, originating with the enactment of the Article 3J tax credits, is "development tier one area." A development tier one area is a county whose annual ranking is one of the 40 highest in the State. Second, it deletes the wage standard requirement to be consistent with the current law as it applies to a tier one area. In 2002, the General Assembly eliminated the wage standard for enterprise tier one and two areas[19] but a conforming change was not made to this statute. At the time, there was only one taxpayer that qualified for the credit, and the wage standard was only required to be met at the time construction began on the facility, which had already occurred. However, to the extent there may be taxpayers who qualify for this credit, which is only available in a tier one area, in the future,

[19] S.L. 2002-172.

	the statute should be amended to reflect the fact that the wage standard is no longer a requirement in a tier one area.
14.3	This section inserts a word that was inadvertently omitted.
14.4(a)	This section deletes the definition of "Dependent" because the term is not required after the changes made by House Bill 998, S.L. 2013-316.
14.4(b) &14.5	This section updates the terminology used in the statutes authorizing withholding of income tax from wages. After House Bill 998, S.L. 2013-316, "exemptions" are not part of the computation of estimated tax to withhold from wages. Instead, the Department of Revenue uses the term "allowances."
14.6	This section deletes a statutory formula used to calculate the amount of estimated tax to withhold from pension payments where the recipient fails to file a withholding tax form. After House Bill 998, S.L. 2013-316, the statutory formula no longer approximates recipient's tax liability. Recipients who do not complete the tax form to calculate withholding from pension payments will be treated the same as employees who do not complete the tax form.
14.7	This section makes technical changes to sales tax definitions. It deletes the word "retail" within the definition of "net taxable sales" because the term is already included by virtue of the definition of the term "gross sales." It also deletes the word "the" in the definition of "retailer" because "engaged in business" is the proper defined term.
14.8	This section makes various technical changes to the sales tax imposition statute.
14.9	This section clarifies that a facilitator who is liable for tax[20] must obtain a certificate of registration like other retailers. A facilitator is a person, other than a real estate agent, who contracts with a provider of an accommodation to market the accommodation and who accepts payment from the consumer for the accommodation. An example of a facilitator would be an online travel company like Expedia, Orbitz, or Priceline.
14.10	This section provides for the applicable due date for a sales tax payment if the due date falls on a weekend or holiday or on a day that the Federal Reserve Bank is closed, which prohibits a person from making a payment by ACH[21] Debit or Credit. These provisions are currently contained in an informational document on the Department's website, but there is not a specific statute, other than one that applies only to payment of property taxes.[22]

[20] Under G.S. 105-164.4(a)(3), a facilitator must send the retailer the portion of the sales price that the facilitator owes the retailer plus the tax due once the accommodation rental marketed by the facilitator is completed. A facilitator that does not send the retailer the tax due on the sales price is liable for the amount of tax the facilitator failed to send.

[21] Automated Clearing House Debit is a method of payment that enables companies to electronically withdraw funds from bank accounts using bank routing numbers and individual account number.

[22] G.S. 105-395.1.

14.11	This section changes from March 1 to March 15 the annual due date for the captive insurance tax return. S.L. 2013-116 provided that the annual report due date for some captive insurance companies is March 1 and, for others, such as a pure captive, it is March 15. The tax returns for all captives are due March 1. This year, the pure captive insurance companies filed premium tax returns by the March 1 due date and attached to the return copies of pages from their annual reports in support of the premium information marked "draft" since the tax return was due before the financial statement. This issue would be eliminated by changing the due date for all premium tax returns to March 15.
14.12	This section makes one technical change and one substantive change. The technical change corrects a statutory reference. The substantive change would add a new criminal offense to the list of offenses for which the Secretary of Revenue may appoint employees of the Criminal Investigations Division to serve as revenue law enforcement officers. The new offense, which was created by the General Assembly in 2013, is for the possession, transfer, or use of an automated sales suppression device, informally known as "tax zapper software."
14.13	This section provides the Department of Revenue with guidance on how to treat amended returns filed under two repealed taxes. Subsections (a) and (b) provide guidance for amended returns filed under the franchise tax on electricity. Subsections (c) and (d) provide guidance for amended returns filed under the excise tax on piped natural gas. Subsections (e) and (f) clarify that only cities that received a distribution under the repealed franchise tax and excise tax will receive distributions from the new sales tax on electricity and piped natural gas. The Tax Reduction Act, S.L.2013-316, included electricity and piped natural gas in the State sales tax base while repealing the utility franchise tax on electricity and the excise tax on piped natural gas. A portion of both of the repealed taxes was shared with the cities. The Tax Reduction Act replaced the tax-sharing revenue under the repealed taxes with a distribution of part of the sales tax on electricity and piped natural gas. The amount distributed to each city under the sales tax is based on the distribution under the repealed taxes the last year those taxes were in effect. Utilities are allowed to file amended returns on the repealed taxes for up to three years. Amended returns filed on the repealed taxes can change both distributions under the repealed taxes and the amount to be distributed to cities under the new sales tax on electricity and piped natural gas. These sections provide guidance to the Department on how to treat amended returns that change past and future distributions. First, it provides that any additional funds needed for increases to past distributions under the repealed taxes can be drawn from the sales tax revenue. Second, it creates a date certain for the future distributions to be determined. The Department of Revenue will set the distributions for each fiscal year by September 15 using amended returns processed by the Department prior to July 31 of that year.

14.14	Property that is appraised at its present use value may remain in the program if the property is under an enforceable conservation easement that would qualify for the conservation easement tax credit. S.L. 2013-316 repealed the conservation easement tax credit for taxable years beginning on or after January 1, 2014. The repeal of the tax credit was not intended to effect property in the present use value program. This section puts the applicable provisions that were provided in the tax credit statutes in Chapter 113A and makes the necessary conforming changes in other statutes.
14.15	This section deletes an inconsistent effective date for the repeal of G.S. 105-159.2 which formerly allowed a taxpayer to checkoff a donation to the North Carolina Public Campaign Fund. Section 38.1.(f) of S.L. 2013-381 repealed G.S. 105-159.2 effective July 1, 2013. This section makes the effective date of a duplicative repeal in Section 21.1.(c) of S.L. 2013 360 effective at the same time.
14.16	This section updates from January 2, 2013, to December 31, 2013, the reference to the Internal Revenue Code. This change keeps the statute up to date, but does not result in any substantive changes because there have not been any federal tax law changes since January 2, 2013, that impact the calculation of North Carolina taxable income.
14.17	This section changes the name of the document filed by the Secretary of Revenue to release an erroneous tax lien. Currently, the Department of Revenue files a "certificate of release" that credit reporting agencies treat as a negative item on a credit report. The renamed document, "certificate of withdrawal," is expected to cancel the original tax lien without impacting the taxpayer's credit report. This section is effective when it becomes law.
14.18	S.L. 2013-157 made a number of changes to North Carolina's Limited Liability Company Act. Among the changes was a new defined term of "company official" defined as: "*Any person exercising any management authority over the limited liability company whether the person is a manager or referred to as a manager, director, or officer or given any other title*." This section incorporates the new term into the responsible person statute, which provides for personal liability when certain taxes are not paid. The section also removes the limitation on the type of withholding taxes that can be collected from a responsible person. Current law allows the Department of Revenue to hold business operators liable for income tax withheld on employee wages. This section eliminates the requirement that the withholding be for employee wages. For example, withholding on independent contractors could now be collected from responsible persons. This section is effective when it becomes law.
14.19	This section updates a statutory reference.
14.20	S.L. 2013-316 repealed the individual income tax credit for property taxes paid on farm machinery. This section removes references to the tax credit that are no longer needed in the property tax statutes.

14.21	This section makes a technical correction by adding (32a) to the list of exempt inventories for which a person need not provide a report under G.S. 105-315 and makes stylistic changes to update the statute.
14.22	This section repeals an obsolete subsection. G.S. 105-537(d) provides that a county may not levy the one-quarter cent sales and use tax under Article 46 if it also levies the land transfer tax under Article 60. Article 60 was repealed by S.L. 2011-18.
14.23	This section corrects a Session Law reference in last year's Revenue Laws Technical changes act with respect to a local occupancy tax act.
14.24	This section creates a new limited registration plate for vehicles that are registered after the prior registration on the vehicle has expired. Current law provides for a limited registration plate for an initial registration, but there is not a similar provision for registration renewals. This section is designed to solve two customer service problems, one involving military service members, and the second involving appeals for vehicle valuations where the customer has not been given an opportunity to appeal the valuation. There are instances where an individual can choose not to renew the registration on a vehicle for a year or longer. As long as the vehicle is not being driven, this is allowed under the law. When the vehicle will be operated again, the owner must renew the vehicle registration. Under Tax & Tag Together, when the individual renews the registration, property taxes on the vehicle for the upcoming tax year are due at the time of renewal. Military service members – The federal Service Members Civil Relief Act provides that personal property (including vehicles) of service members is not subject to personal property taxes simply due to the fact that the member is serving in the state. Active duty service members often do not renew vehicle registrations when the member is deployed overseas. Under Tax & Tag Together, when a service member returns from deployment and seeks to renew a vehicle registration, the system will not allow the vehicle to be registered without payment of the property tax, even if the service member does not owe the tax. Valuation appeals – Under current law, individuals may appeal the valuation assigned to a motor vehicle for property tax purposes. Taxpayers are given notice of the valuation of the vehicle and the right to appeal on the combined property tax notice. The combined notice is sent 60 days prior when the taxes are due. However, if an individual has allowed the registration to lapse more than a year, the individual would not have received a bill and would not have received notice of the tax value for the upcoming property tax year. Under the current system, the taxpayer will not be able to renew the vehicle registration without paying the tax for which the taxpayer did not have the opportunity to appeal. This section allows a temporary limited registration plate to be issued in both of these circumstances. Once the limited registration plate is issued, the

	taxpayer would have 60 days to remedy the tax issue. Once the tax issue has been resolved, the taxpayer could apply for a permanent tag.
14.25	This section sets the rate of tax on low street value drugs sold by weight at $50.00 per gram.
14.26	This section corrects a statutory reference.
14.27	This section makes a conforming change to the ticket scalping statute to related to the admissions changes.
14.28	This section makes technical changes to the reciprocity statute.

PART XV: VAPOR PRODUCTS AND PROHIBIT USE OF VAPOR PRODUCTS IN JAILS

SUMMARY: Part XV of S.L. 2014-3 imposes an excise tax of 5¢ per milliliter on vapor products, and prohibits the use of vapor products in State correctional facilities. Part XV of S.L. 2014-3 prohibited the use of vapor products in local confinement facilities. However, section 23 of S.L. 2014-115 repealed the prohibition of the use of vapor products in local confinement facilities and authorized local confinement facilities to provide vapor products and FDA-approved tobacco cessation products to inmates in those facilities.

CURRENT LAW: Under G.S. 105-113.5 cigarettes are taxed at 45¢ per pack. Other tobacco products (OTP), including pipe tobacco and roll-your-own tobacco is taxed under G.S. 105-113.35 at 12.8% of the cost of the product. The tax on cigarettes is paid by the distributor of the product. The tax on OTP products is payable by the wholesale dealer or retail dealer who first acquires or otherwise handles the product.

An electronic cigarette is a handheld device that produces vapor from a liquid. The liquid is generally heated to produce the vapor by a battery operated device. The liquid usually contains nicotine and sometimes contains flavors. The amount of the nicotine in the liquid can vary. Most electronic cigarettes are reusable. The liquid in the device can either be replenished replacing the cartridge that holds the liquid, or by manually refilling the liquid container.

In 2009, Congress enacted the Family Smoking Prevention and Tobacco Control Act, which gave the US Food and Drug Administration (FDA) the authority to regulate new tobacco products including e-cigarettes, nicotine gels, cigars, pipe tobacco, and dissolvable nicotine products.

In April 2014, the FDA issued proposed rules to regulate e-cigarettes. The proposed rules will be subject to 75 days of public comment. The proposed rules deem e-cigarettes a "tobacco product" for the purpose of federal regulation. The rules further propose to subject e-cigarettes to the following restrictions:

- Enforcement against adulterated or misbranded products.
- Ingredient disclosure and reporting of harmful components
- No modified risk descriptors (light cigarettes)
- No free samples

- Premarket review
- Minimum age for purchase

G.S. 148-23.1 prohibits the use and possession of tobacco products anywhere on the premises of a State correctional facility. Exemptions are provided for use and possession for religious purposes consistent with the policies of the Department of Public Safety (DPS), and also for possession by employees or visitors within the confines of a motor vehicle located in a parking area if the tobacco product remains in the vehicle and the vehicle is locked when the employee or visitor exits the vehicle.

G.S. 14-258.1 provides that it is a Class 1 misdemeanor to do either of the following:

- To knowingly give or sell tobacco products to an inmate on the premises of a correctional facility or in the custody of a local confinement facility, or to a person for delivery to an inmate.
- For an inmate in the custody of a local confinement facility to possess tobacco products.

BILL ANALYSIS:

Excise tax: Section 15.1 of S.L. 2014-3 imposes an excise tax of 5¢ per milliliter of the consumable product of vapor products. Vapor products are defined as noncombustible products that use a heating element to produce vapor from nicotine in a solution. The consumable product is the part of the vapor product that contains the nicotine liquid solution. All invoices for vapor products must contain the amount of the consumable product in milliliters.

Vapor products are considered a subset of the other tobacco products, therefore, the tax would be administered as the tax on OTP. The tax must be paid the wholesale dealer or retail dealer who first acquires or otherwise handles the product. The tax does not apply to products sold outside the State, products sold to the federal government, or products distributed without charge. Taxes are paid monthly. Each dealer must keep sufficient records of vapor products transactions.

Wholesale dealers and retail dealers must obtain a license for each place of business that handles tobacco products. The license fee for wholesale dealers is $25, and the license fee for retail dealers is $10.

Taxpayers that file timely returns and payments of the taxes on OTP are allowed a discount of 2% of the amount due. The discount does not apply to the tax on vapor products.

No vapor in prisons: Section 15.2(a) of S.L. 2014-3 prohibits the use of vapor products in State correctional facilities. Exemptions are provided for use and possession for religious purposes consistent with the policies of DPS, and for possession by employees or visitors within the confines of a motor vehicle located in a parking area if the vapor product remains in the vehicle and the vehicle is locked when the employee or visitor exits the vehicle.

Use of vapor products in local confinement facilities: Section 15.2(b) of S.L. 2014-3 created a Class 1 misdemeanor for an individual convicted of either of the following:

- To knowingly give or sell vapor products to an inmate on the premises of a correctional facility or in the custody of a local confinement facility, or to a person for delivery to an inmate.

- For an inmate in the custody of a local confinement facility to possess vapor products.

Section 23 of S.L. 2014-115 repealed the criminal offense for inmates of local confinement facilities to possess vapor products and specifically authorizes local confinement facilities to provide vapor products and FDA-approved tobacco cessation products to inmates.
EFFECTIVE DATE: The provisions related to imposing the excise tax on vapor products are effective June 1, 2015. The provisions related to vapor products in State confinement facilities are effective July 1, 2014. The provisions related to vapor products in local confinement facilities are effective December 1, 2014.

ENERGY MODERNIZATION ACT.

Session Law	*Bill #*	*Sponsor*
S.L. 2014-4	**SB 786**	**Sen. Rucho, Newton, Brock**

AN ACT TO (1) EXTEND THE DEADLINE FOR DEVELOPMENT OF A MODERN REGULATORY PROGRAM FOR THE MANAGEMENT OF OIL AND GAS EXPLORATION, DEVELOPMENT, AND PRODUCTION IN THE STATE AND THE USE OF HORIZONTAL DRILLING AND HYDRAULIC FRACTURING TREATMENTS FOR THAT PURPOSE; (2) ENACT OR MODIFY CERTAIN EXEMPTIONS FROM REQUIREMENTS OF THE ADMINISTRATIVE PROCEDURE ACT APPLICABLE TO RULES FOR THE MANAGEMENT OF OIL AND GAS EXPLORATION, DEVELOPMENT, AND PRODUCTION IN THE STATE AND THE USE OF HORIZONTAL DRILLING AND HYDRAULIC FRACTURING TREATMENTS FOR THAT PURPOSE; (3) AUTHORIZE ISSUANCE OF PERMITS FOR OIL AND GAS EXPLORATION, DEVELOPMENT, AND PRODUCTION ACTIVITIES SIXTY DAYS AFTER APPLICABLE RULES BECOME EFFECTIVE; (4) CREATE THE NORTH CAROLINA OIL AND GAS COMMISSION AND RECONSTITUTE THE NORTH CAROLINA MINING COMMISSION; (5) AMEND MISCELLANEOUS STATUTES GOVERNING OIL AND GAS EXPLORATION, DEVELOPMENT, AND PRODUCTION ACTIVITIES; (6) ESTABLISH A SEVERANCE TAX APPLICABLE TO OIL AND GAS EXPLORATION, DEVELOPMENT, AND PRODUCTION ACTIVITIES; (7) AMEND MISCELLANEOUS STATUTES UNRELATED TO OIL AND GAS EXPLORATION, DEVELOPMENT, AND PRODUCTION ACTIVITIES; AND (8) DIRECT STUDIES ON VARIOUS ISSUES, AS RECOMMENDED BY THE JOINT LEGISLATIVE COMMISSION ON ENERGY POLICY.

SUMMARY: ***S.L. 2014-4 contains two tax provisions. Part VI of the act imposes a new severance tax on oil, gas and condensates extracted from the State. Section 30 of the act revises the motor fuels taxation of compressed natural gas and liquefied natural gas.***

PART VI: SEVERANCE TAX

Part VI of S.L. 2014-4 repeals North Carolina's previous severance tax and levies a new severance tax on the removal of energy minerals from the soil and water of the State. The previous State severance tax was enacted in 1945 and had not been modified since 1973. The previous tax was five mills on each barrel of oil (the equivalent of .5¢ per barrel of oil) and one-half mill on each 1000 cubic feet of gas (the equivalent of .05¢ per 1000 cubic feet of gas). No tax was collected under the previous law. The new severance tax adds condensates to the tax base, raises the tax rate on oil, and creates a floating tax rate for gas.

Energy minerals are defined in the act to include all forms of natural gas, oil, and related condensates. Thirty-three states, including North Carolina, currently impose some form of severance taxes on the extraction of oil and gas. Of the 33 states, 25 states impose a tax as a percentage of the value of the resource extracted, 7 states impose a tax on the volume extracted, and 1 state imposes a tax that is a combination of the two methods.

Tax Rate – Marginal gas is the gas produced from a well that is only capable of producing a small amount of gas (no more than 100 MCF of gas). The tax rate for the severance of energy minerals is as follows:

	2015-2018	2019-2020			2021-2023			2023 and thereafter		
Oil and condensates	2%	3.5%			5%					
Marginal Gas	.4%	.6%			.8%					
Gas	.9%	Based on *delivered to market* price per mcf			Based on *delivered to market* price per mcf			Based on *delivered to market* price per mcf		
		Over	Up to	Rate	Over	Up to	Rate	Over	Up to	Rate
		-0-	$3	.9%	-0-	$3	.9%	-0-	$3	.9%
		$3.01	$4	1.9%	$3.01	$4	1.9%	$3.01	$4	1.9%
		$4.01	NA	2.9%	$4.01	$5	2.9%	$4.01	$5	2.9%
					$5.01	$6	3.9%	$5.01	$6	3.9
					$6.01	$7	4.9%	$6.01	$7	4.9%
					$7.01	NA	5%	$7.01	$8	5.9%
								$8.01	$9	6.9%
								$9.01	$10	7.9%
								$10.01	NA	9%

Tax Base – For condensates and oil, the tax rate is applied to the total actual gross price paid by the first purchaser of the condensate or oil. For gas, the tax rate is applied to the "delivered to market" value of the mineral sold. The "delivered to market value" of gas is the actual gross price paid minus the costs incurred by the producer to get the gas from the mouth of the well to the first purchaser.

Administration – The tax is the liability of the producer of the gas. The producer is the entity that extracts the mineral from the soil or the water of the State. Returns and taxes

are due on either a monthly or quarterly basis, depending on the tax liability of the producer. A bond or letter of credit would be required for producers that fail to file a return or make a payment of tax due.

Permit Suspension – Permits for oil and gas exploration using horizontal drilling or hydraulic fracturing would be suspended for any producer that fails to file a return or make a payment for severance taxes.

No Local Taxes – Local governments would not be authorized to impose any additional taxes on the severance of energy minerals in the State.

Property Taxes – The value of real property attributable to the presence of energy minerals is exempt from taxation where a permit to drill on the property has not been issued.

SECTION 30: MOTOR FUELS TAX ON LNG AND CNG

Section 30 of S.L. 2014-4 adopts the gas gallon equivalent (GGE) equivalent for compressed natural gas and the (diesel gas equivalent) DGE equivalent for liquid natural gas for the purpose of motor fuel taxation.

The motor fuel tax rate has two components, a flat rate of 17.5¢, and a variable rate of the greater of 3.5¢ per gall on or 7% of the wholesale price of gas of the preceding six month base period. S.L. 2013-316 capped the motor fuel tax rate at 37.5¢ until June 30, 2015. Alternative fuels are taxed at the motor fuel rate. Unless otherwise provided, the Secretary will determine the equivalent rate for alternative fuels. The gas gallon equivalent (GGE) or diesel gas equivalent (DGE) is the amount of an alternative fuel that is needed to generate the same amount of energy of either a gallon of gas or a gallon of diesel.

The Department of Revenue adopted a GGE at 5.66 pounds for compressed natural gas in 1996. The International Fuel Tax Agreement (IFTA), which is used to report and distribute motor fuel taxes from motor carriers that operate in multiple jurisdictions, adopted the GGE for compressed natural gas earlier this year. The GGE equivalent is 5.66 pounds of compressed natural gas. The DGE equivalent of liquefied natural gas is 6.06 pounds of liquefied natural gas.

SOIL & WATER/REGIONAL JAILS REFUNDS.

Session Law	*Bill #*	*Sponsor*
S.L. 2014-20	**HB 558**	**Rep. Whitmire, Ramsey, Dixon, Waddell**

AN ACT TO ALLOW SALES TAX REFUNDS FOR SOIL AND WATER CONSERVATION DISTRICTS AND REGIONAL JAILS.

SUMMARY: House Bill 558, S.L. 2014-20, authorizes a sales tax refund for soil and water conservation districts and regional jails.

CURRENT LAW: G.S. 105-164.14 authorizes certain governmental entities to receive an annual refund of certain sales and use taxes paid on direct purchases of tangible personal property and services.

A soil and water conservation district is a governmental subdivision of this State, and a public body corporate and politic, organized in accordance with the provisions Chapter

139 of the General Statutes. According to the North Carolina Division of Soil and Water Conservation, there are 96 local conservation districts in the State. Districts partner with federal, state and local entities to deliver state and federal conservation programs related to water quality practices, farmland protection, wetlands restoration and wildlife habitat enhancement. Districts assist with community conservation planning in natural resource management areas, such as erosion and sediment control, stormwater management, flood control, water use efficiency, stream restoration, small-plot forestry management and restoration efforts after natural disasters. Districts also help implement conservation easements and respond to local projects, such as building environmental education centers.

A local confinement facility is a county or city jail, a local lockup, a regional or district jail, a juvenile detention facility, a detention facility for adults operated by a local government, and any other facility operated by a local government for confinement of persons awaiting trial or serving sentences. G.S. 153A-219 authorizes two or more units of local government to enter into an agreement to establish and operate a district confinement facility.

BILL ANALYSIS: The bill would add the following to the list of governmental entities entitled to an annual sales tax refund:

- Soil and water conservation districts organized under Chapter 139 of the General Statutes.
- District confinement facilities created under G.S. 153A-219, including those created under a local act modifying G.S. 153A-219.

EFFECTIVE DATE: House Bill 558, S.L. 2014-20, became effective July 1, 2015, and applies to sales made on or after that date.

CAPE HATTERAS/GAS CITIES/INFRASTRUCTURE LAND.

Session Law	*Bill #*	*Sponsor*
S.L. 2014-39	**SB 790**	**Senator Cook**

AN ACT TO PHASE IN THE SALES TAX RATE ON ELECTRICITY SOLD BY CAPE HATTERAS ELECTRICAL MEMBERSHIP CORPORATION AND THE SALES TAX RATE ON PIPED NATURAL GAS SOLD BY GAS CITIES, TO MODIFY THE PROPERTY TAX DEFERRAL PROGRAM FOR SITE INFRASTRUCTURE LAND, AND TO DELAY THE CHANGE IN THE HIGHWAY USE TAX BASE TO INCLUDE DEALER ADMINISTRATIVE FEES.

SUMMARY: S.L. 2014-39, Senate Bill 790, does the following:

- ***Phases-in the sale tax on sales of electricity by the Cape Hatteras Electric Membership Corporation over two years.***
- ***Phases-in the sales tax on sales of piped natural gas by the eight gas cities.***
- ***Modifies the infrastructure property tax deferral program, enacted last year as S.L. 2013-130.***
- ***Makes a technical change to ensure that the expansion of the highway use tax base to include dealer administrative fees is delayed from July 1, 2014, to October 1, 2014.***

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CURRENT LAW, BILL ANALYSIS, AND EFFECTIVE DATE:

Phase-In Sales Tax Rate

S.L. 2013-316 (*Tax Simplification and Reduction Act*) provided for the uniform taxation of all utilities. The Act repealed the franchise tax on electricity and increased the sales tax on electricity to the combined general rate of 7%. It also repealed the excise tax on piped natural gas and replaced it with a sales tax at the combined general rate of 7%. These sales tax changes become effective July 1, 2014.

Currently, Cape Hatteras Electric Membership Corporation (EMC) is not liable for franchise tax or sales tax on its sale of electricity. Other EMCs are subject to franchise tax and sales tax on their sale of electricity. Currently, the eight gas cities are not subject to the excise tax on their sale of piped natural gas. The eight gas cities are Bessemer City, Greenville, Kings Mountain, Lexington, Monroe, Rocky Mount, Shelby, and Wilson. Sales of piped natural gas by other providers are subject to the excise tax. S.L. 2013-316 did not retain these exemptions. Section 1 of the House PCS would phase-in the sales tax rate on these sales of electricity and piped natural gas over two years: effective July 1, 2014, the sales tax rate would be 3.5%; and effective July 1, 2015, the sales tax rate would be the same as the rate paid by other consumers of these products, 7%.

Cities receive a share of the sales tax imposed on piped natural gas. Under the former excise tax system, the amount was one-half of the amount of tax attributable to that city based on gas delivered to sales or transportation customers in the city and gas received in each city by persons who have direct access to an interstate pipeline and who receive the gas for their own consumption. Beginning July 1, 2014, there is a different formula for distributing the proceeds to the cities. Moreover, the formula for gas cities differs from other cities. Subsections (b), (c), and (d) of this section clarify how the distribution is calculated for gas cities and provide that gas cities do not receive a distribution of the sales tax revenue derived from the reduced rate. A similar change is not necessary for the distribution of sales tax imposed on electricity for cities because there is no existing distribution impacted by the reduced rate for electricity sold by the Cape Hatteras EMC.

Electric membership corporations (EMCs) are not-for-profit entities that provide electric service in rural areas. North Carolina enacted legislation to allow EMCs in 1935 to promote electric service in the State. EMCs are not regulated by the Utilities Commission, but are governed by the board of directors that are elected by the customers of the EMC. Prior to 1965, each EMC was designated as a "public agency." As public agencies, the EMCs did not pay taxes on the sales of electricity by the EMCs. In 1965, the General Assembly enacted legislation clarifying the service area territories of EMCs and investor-owned public utilities. As part of the negotiation over the service areas, the legislation repealed the "public agency" designation for most of the EMCs. However, Cape Hatteras EMC retained its status as a "public agency" under the law. In 2000, the Department of Revenue informed Cape Hatteras EMC it would be required to remit sales tax on its sales of electricity.[23] Cape Hatteras paid the tax, but also filed suit for the return of taxes and clarification of its liability for the tax. In 2011, the North Carolina Court of Appeals held that Cape Hatteras EMC was not liable for the franchise or the sales tax on its sales of electricity.[24] S.L.

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[23] In 1965, only the franchise tax was imposed on the sale of electricity. In 1984, the General Assembly lowered the franchise tax on electricity and imposed a sales tax on sales of electricity.

[24] *Cape Hatteras Electric Membership Corporation v. Lay*, 210 N.C. App. 92 (2011).

2013-316 specifically repealed the prior legislation that designated Cape Hatteras EMC as a "public agency" and stated "Cape Hatteras Electric Membership Corporation is subject to any other taxes to the same extent as other electric membership corporations established under Chapter 117 of the General Statutes.

Prior to 1999, the sale of piped natural gas was subject to sales and use tax, but sales by gas cities were exempt. In 1999, the sales and use tax on piped natural gas was replaced with a new excise tax. The new excise tax system preserved the tax exemption for gas received by a gas city for consumption by that city and for or gas delivered by a gas city to a sales or transportation customer of the gas city. A "gas city" is a city in this State that operated a piped natural gas distribution system as of July 1, 1998. There are only eight gas cities: Bessemer City, Greenville, Kings Mountain, Lexington, Monroe, Rocky Mount, Shelby, and Wilson. S.L. 2013-316 did not retain this exemption.

Modify the Property Tax Deferral Program for Site Infrastructure Land

S.L. 2013-130 created a property tax deferral program for sites with potential to be developed for office or industrial applications in order to encourage horizontal improvement so as to make the sites more readily adapted to those uses in a shorter timeframe. In order to qualify, the site must be zoned for office and/or industrial use, must consist of at least 100 acres, may not have a building permit for a primary building or structure issued for it, and must be currently enrolled in or have been enrolled within the previous six months in the PUV program.

Section 2 of the bill removes the qualification that the property be enrolled in the PUV program. It makes a conforming change to the amount of taxes that are deferred. The amount of property tax liability that can be deferred is the portion of tax that represents the increase in the property value resulting from any existing horizontal improvement plus the difference between the property valued at its true value and the property valued as it would have been valued as if it were zoned the same as it was in the calendar year prior to the time the application for property tax relief under this program was filed. The difference in value between property zoned as vacant or agricultural property and property zoned as industrial or office can be large. The change is effective for taxable years beginning on or after July 1, 2015.

The deferred taxes are carried forward in the records of the county and, if applicable, the city in which the property is located until the occurrence of a disqualifying event. A disqualifying event causes the current years' tax liability (without benefit of the program) and some previous years' deferred tax liability to be due and payable as follows:

- If, within five years of classification, an amount equal to the deferred taxes is not invested in improvements to make the land suitable for office and/or industrial use ("minimum investment"), the deferred taxes for the preceding five years are due and payable.
- If the minimum investment is made but the property is classified for 10 years in the program, the deferred taxes for the preceding five years are due and payable.
- If some or all of the land is rezoned for a use other than office and/or industrial use, all deferred taxes are due and payable.

- If land is transferred or a building permit issues for the land, the deferred taxes (for only that portion transferred or to which the permit applies) for the preceding year are due and payable. The remaining parcel continues to receive treatment under this classification, even if it no longer meets the size requirement.

Delay the Change in the Highway Use Tax Base to include Dealer Administrative Fees

In S.L. 2013-360, the Current Operations and Capital Improvements Appropriations Act of 2013, the highway use tax base was expanded to include any dealer administrative fees, effective January 1, 2014. Almost immediately, in S.L. 2013-363, the implementation of this change was delayed until July 1, 2014. Although the Current Operations and Capital Improvements Appropriations Act of 2014, Senate Bill 744, is in conference, both the Senate and the House passed Section 34.6 in that bill that would delay the implementation of this provision until October 1, 2014. S.L. 2014-3 rewrote the relevant highway use tax statute, effective October 1, 2014.

Section 3 of this bill makes a technical change by repealing the two provisions related to this change enacted last year, and thus allowing the change enacted in S.L. 2014-3 to become effective October 1, 2014. Without this change, the highway use tax base will change to include dealer administrative fees effective July 1, 2014, instead of the agreed upon date of October 1, 2014. If this provision is enacted, the corresponding budget section 34.6(a) of Senate Bill 744 will no longer be needed.

911 BOARD/BACK-UP PSAP.

Session Law	*Bill #*	*Sponsor*
S.L. 2014-66	**SB 797**	**Senator Brock**

AN ACT TO AMEND THE DUTIES OF THE 911 BOARD RELATING TO PUBLIC SAFETY ANSWERING POINTS, AS RECOMMENDED BY THE JOINT LEGISLATIVE OVERSIGHT COMMITTEE ON INFORMATION TECHNOLOGY, AND TO CLARIFY THE COLLECTION AUTHORITY OF THE DEPARTMENT OF REVENUE FOR THE 911 FEE ON PREPAID WIRELESS.

SUMMARY: S.L. 2017-66 requires public safety answering points (PSAPs) to provide the capability to provide 911 call taking in the event the primary PSAP cannot process calls. The act also clarifies the authority of the Department of Revenue to collect the 911 fee on prepaid wireless service, and clarifies the fees the Department may retain as costs of administering collection.

CURRENT LAW: A monthly fee of 60¢ is imposed on each telecommunications subscriber. Other than prepaid wireless providers, each provider of telecommunications service collects the 911 fee from each subscriber of their service. Until July 1, 2013, the 911 fee was not collected on prepaid wireless phones. S.L. 2011-122 imposed the fee on retailers of prepaid wireless service. The 911 fee on prepaid wireless is collected by the Department of Revenue and remitted to the 911 Board each month within 45 days of the end of the month the service charges were collected.

The 911 Board distributes the 911 fees to "public safety answering points" (PSAP). Each PSAP is the public safety agency that receives incoming 911 calls and dispatches public

safety agencies in response. The distributions from the 911 fees may only be used for certain eligible purchases by the PSAP.

BILL ANALYSIS: S.L. 2014-66 requires each PSAP to plan for 911 call taking in the event the primary PSAP cannot process calls. PSAPs will be authorized to use distributions from the 911 Fund to pay for dispatch equipment at a back-up PSAP. As of July 1, 2016, PSAPs will not be eligible for distributions from the 911 Fund if the PSAP does not have a back-up PSAP.

S.L. 2014-66 also clarifies the authority of the Department of Revenue to collect the 911 fee on prepaid wireless service. Although the fee is not a tax, the Department collects the fee from retailers. The initial legislation authorizing the collection of the fee limited the authority of the Department to certain administrative provisions. The Department has requested this clarification to provide that the Department may enforce collection of the fee.

The Department of Revenue is authorized to retain the costs of collecting the fee on prepaid wireless, not to exceed $500,000 a year. The original legislation allowed the Department to retain and additional $200,000, for a total of $700,000 in the 2013-14 fiscal year, to pay for start-up costs. Due to a delay in the implementation of the Department's new computer system, the Department only retained $60,000 in total costs in the 2013-14 fiscal year. This provision authorizes the Department to retain the additional $140,000 in start-up costs for the 2014-15 fiscal year, allowing the Department a total of $640,000 for costs retained in the 2014-15 fiscal year.

EFFECTIVE DATE: The provisions related to back-up PSAPs was effective when it became law and applies to PSAP distributions on or after July 1, 2016. The provisions related to the Department of Revenue retaining costs of collecting the 911 fee was effective July 1, 2014.

SPECIAL LICENSE PLATE DEVELOPMENT PROCESS.

Session Law	*Bill #*	*Sponsor*
S.L. 2014-96	**HB 101**	**Rep. Martin, Howard, Moffitt, Setzer**

AN ACT TO REAUTHORIZE EXPIRED SPECIAL REGISTRATION PLATES, TO AUTHORIZE ADDITIONAL SPECIAL REGISTRATION PLATES TO BE ON A BACKGROUND OTHER THAN THE "FIRST IN FLIGHT" BACKGROUND, AND TO ESTABLISH A PROCESS BY WHICH PERSONS OR ORGANIZATIONS MUST OBTAIN A MINIMUM NUMBER OF PAID APPLICATIONS PRIOR TO OBTAINING LEGISLATIVE APPROVAL FOR THE DEVELOPMENT OF A SPECIAL REGISTRATION PLATE.

SUMMARY: Session Law 2014-96 does the following:

- ***It reenacts the 116 special registration plates that expired on July 1, 2013, until October 1, 2014.***
- ***It authorizes 4 existing or reauthorized plates to be on a full-color background, assuming the organization obtains the minimum number of required paid applications before their authorization expires.***

- ***It creates a new process for establishing or reenacting special registration plates that requires an organization to obtain the minimum number of paid applications and submit the total payment to DMV prior to seeking legislation authorizing the plate.***

CURRENT LAW: North Carolina offers approximately 150 special license plates. The process for developing a special license plate is not codified or published; an organization usually contacts a legislator or DMV to find out what the process is.

Generally speaking, an organization seeking a special license plate must find a legislative member to sponsor a bill authorizing the plate. Once the legislation is enacted, an organization must contact DMV for the next steps of the process. DMV may assist the organization with developing a form or will direct the organization to develop its own form to give to potential purchasers who want to apply for the plate. An organization must then collect the minimum number of paid applications and develop the artwork for the plate. The issuance of most plates is contingent upon the receipt by DMV of at least 300 applications for the particular plate if it is on a standard "First in Flight" background or at least 500 applications if it is on a full-color background. Once DMV has the list of purchasers, payment from those purchasers, and the final artwork, it will proceed with developing the plate. Over the years, there have been many more authorizations for plates than actual plates that have been developed, either due to an inability to meet the minimum number of applications or lack of knowledge about the process.

Once a plate is developed and available for purchase, a person may, upon application and payment of the required fees, obtain from DMV a special registration plate for a motor vehicle registered in that person's name if the person qualifies for the registration plate. As a general rule, the fee for a special registration plate is the regular vehicle registration fee, which is $28, plus a $10 special registration plate fee. The $10 special registration plate fee is credited to the Special Registration Plate Account. After deducting the cost of the plates from this account, $1.3 million is appropriated to provide operating assistance for Visitor Centers. The remaining revenue in the account is transferred quarterly to the Department of Commerce for advertising (33%), the Department of Transportation for highway beautification (50%), and the Department of Human Resources to promote travel accessibility for disabled persons (17%).

BILL ANALYSIS:

Temporary Reauthorization of Expired Plates

In 2011, the General Assembly created a mechanism by which special license plate authorizations would expire if the sponsoring organization had not obtained the minimum number of paid applications within two years of the plate being authorized or within two years of the passage of that legislation for plates authorized prior to July 1, 2011. On July 1, 2013, the authorization for 116 special license plates expired.[25] At least one of those organizations has indicated that it subsequently obtained the minimum number of paid applications.

Section 1 of the act reauthorizes the expired plates until October 1, 2014. This extension allows an organization that has obtained the required number of paid applications to proceed with the development of its plate. For any organization that does not submit the required number of paid applications to DMV by October 1, 2014, the authorization for

[25] A list of expired plates appears at the end of this Bill Analysis.

the plate will expire on that date. However, any organization for which its authorization expires may proceed under the new process.

Authorize Additional Plates on Full-Color Background

In order for a plate to be on a background other than the "First in Flight" background (referred to as a "full-color plate"), it must be authorized under G.S. 20-63(b1). In 2013, the General Assembly began requiring organizations seeking a full-color plate to obtain an additional 200 paid applications, or a total of 500 paid applications.

Section 2 of the act adds four plates to the list of plates that may be printed on a full-color background. Two of the plates, Native Brook Trout and Red Drum, were authorized last year. Those plates have until July 1, 2015, to obtain 500 paid applications in order for the plate to be produced. Otherwise, the authorization will expire. The other two plates, S.T.A.R. and Alpha Phi Alpha, are plates being reenacted by this bill. They have until October 1, 2014, to obtain 500 paid applications or the authorization will expire.

New Special License Plate Development Process

Section 3 of the act establishes a new process for establishing or reauthorizing special license plates. This would codify the process and require DMV to explain the process on its website so that the public is aware of the process. The new process would be similar to the current process, except that the timing shifts as to when a requesting organization must obtain the minimum number of paid applications. The new process becomes effective October 1, 2014.

The new process will operate as follows:

Step 1: Organization Obtains Paid Applications

An organization seeking a plate would obtain a form from DMV to be completed by potential purchasers. DMV must make this form available on its website by October 1, 2014 **(Section 4)**. The form will explain the application process and the fees that must be remitted to pre-pay for the plate. The organization must collect the minimum number of applications and payment from potential purchasers.

This step is similar to what happens now except that the organization must obtain the applications and payment after the General Assembly has authorized the plate.

Step 2: Organization Submits Development Application & Pre-Payment to DMV

Once an organization has obtained the minimum number of paid applications, it must submit to DMV a Special Registration Plate Development Application along with a single payment representing the total pre-payment received from potential purchasers. The deadline for submission would be February 15 in order for a bill to be considered in the legislative session being held that year. If an organization submits the application after February 15, a bill would be considered in the following year.

Organizations make this same payment to DMV now but only after legislation has been approved and once they have obtained the minimum number of paid applications from potential purchasers. The Special Registration Plate Development Application would be a new form that DMV must develop and make available on its website by February 1, 2015 **(Section 5)**. The form would require the organization to provide identifying information, point of contact information, a description of the proposed plate, the proposed fee for the

plate, the name of at least one current member of the General Assembly who would sponsor legislation authorizing the plate, and sign a statement indicating that it has obtained the minimum number of paid applications.

At this point, an organization should have made contact with a legislator about sponsoring a bill to authorize the proposed plate. This bill does not restrict a member's ability to introduce legislation for a particular plate at any time within the filing deadlines.

Step 3: DMV Reports to General Assembly

By March 15 of each year, DMV would send to the Transportation and Finance chairs of both houses, as well as the Research Division, a list of the applicant-organizations that submitted an application and the required payment. The General Assembly may consider a bill during that year's session to authorize a special plate for those applicant-organizations.

Step 4: General Assembly Approves or Does Not Approve Bill

The General Assembly may approve, disapprove, or take no action on a bill authorizing a special license plate that applied in accordance with this process.

This step is the same as what happens now in that the General Assembly currently has discretion to approve, disapprove, or take no action on a bill authorizing a particular plate.

Step 5: Organization Submits Artwork & List of Purchasers to DMV

If the General Assembly approves the plate, the organization has 60 days within the bill becoming law to submit the artwork and list of purchasers to DMV or the authorization will expire **(Section 6)**. DMV will apply pre-payment at that time. If the General Assembly does not authorize the plate, DMV must refund the payment to the organization, and the organization is responsible for refunding the fees to each of the purchasers.

Step 6: DMV Issues Plate

DMV has 6 months to develop a plate that met all of the necessary requirements.

Deadline Extension for 2015 Session

Section 3(c) extends the deadlines for the first year that the new process would be in place to allow DMV to create and implement the new forms and the application process and to afford members and organizations an opportunity to become aware of and participate in the new process. In order for a bill to be considered in the 2015 Regular Session authorizing a new plate, an organization would have until April 1, 2015 to submit an application to DMV. DMV must report the list of applicant-organizations to the General Assembly by May 1, 2015.

Study of Special Registration Plates and Permanent License Plates

Section 7 of the act directs the Revenue Laws Study Committee to study the new process for special registration plates, as well as the costs incurred by DMV to administer the special plates, and to study the eligibility criteria for permanent license plates and report its findings and recommendations to the 2015 General Assembly.

APPROPRIATIONS ACT OF 2014.

Session Law	*Bill #*	*Sponsor*
S.L. 2014-100	**SB 744**	**Sen. Brown, Harrington, Hunt**

AN ACT TO MAKE BASE BUDGET APPROPRIATIONS FOR CURRENT OPERATIONS OF STATE DEPARTMENTS, INSTITUTIONS, AND AGENCIES, AND FOR OTHER PURPOSES.

***SUMMARY:** The finance sections of the Appropriations Act of 2014 are summarized below.*

- ***North Carolina Education Endowment Fund:** S.L. 2014-100, Sec. 8.11 (SB 744, Sec. 8.11) establishes the North Carolina Education Endowment Fund (Fund) as a special fund to be used solely for differentiated teacher compensation related directly to improving student academic outcomes in the public schools. Revenue for this Fund may be generated from the sale of "I Support Teachers" special registration plates and the designation of tax refunds. Appropriate language and space must be made available on the State income tax form for the irrevocable designation of returns to be made to the Fund. The General Assembly intends to appropriate the funds to local boards of education to implement differential pay plans for highly-effective classroom teachers. This section became effective July 1, 2014, and the option to contribute tax refunds for the purposes of this section applies for taxable years beginning on or after January 1, 2014.*

- ***Reinstatement of Hospital Setoff Debt Collection Against Tax Refunds and Lottery Prizes:** S.L. 2014-100, Sec. 12I.4 (SB 744, Sec. 12I.4) reauthorizes schools of medicine, clinical programs, facility, or practice affiliated with one of the constituent institutions of the University of North Carolina that provide medical care to the general public and The University of North Carolina Health Care System to use the setoff debt collection act. For these persons and entities, debt that may be set off is limited to the sum owed to one of these entities by law or by contract following an adjudication of a claim resulting from an individual's receipt of hospital or medical services at a time when the individual was covered by commercial insurance, Medicaid, Health Choice Medicare, Medicare Advantage, a Medicare supplement plan, or any other government insurance. The registration required of these reauthorized agencies is not affected by the repeal of the authority, and the priority of the agency must be determined under the initial statutory authority to utilize the debt setoff collection remedy. This section became effective August 7, 2014, and applies to tax refunds determined by the Department of Revenue on or after that date and to lottery prizes determined by the Lottery Commission on or after that date.*

- ***Solid Waste Disposal Tax Uses:** S.L. 2014-100, Sec. 14.24 (SB 744, Sec. 14.24) increases, from 13% to 19%, the cap on the percentage of revenues from the solid waste disposal tax allocated to the Department of Environment and Natural Resources for assessment and remediation of pre-1983 landfills that may be used for administrative expenses. This section also broadens the types of administrative expenses that may be funded to include any expense related to hazardous and solid waste management. This section became effective July 1, 2014, and applies to funds credited to the Inactive Hazardous Sites Cleanup Fund on or after that date.*

- ***Motor Fuel Excise Tax: S.L. 2014-100, Sec. 34.6 (SB 744, Sec. 34.6) repeals the quarterly refund for the motor fuel excise tax paid for taxicabs. This section becomes effective for taxable years beginning on or after January 1, 2015.***

- ***Clarify "Net General Fund Tax Collected" for Purposes of the Corporate Income Tax Rate Reduction Trigger: S.L. 2014-100, Sec. 37.1 (SB 744, Sec. 37.1) clarifies what the term "net General Fund tax collected for a fiscal year" means for purposes of the corporate income tax rate trigger in statute. In 2013, the General Assembly reduced the corporate income tax rate from 6.9% to 6% for the 2014 taxable year and to 5% for the 2015 taxable year. In addition to these rate reductions, the law provides for a potential 1% rate reduction for taxable year 2016 if net General Fund tax collections for fiscal year 2014 to 2015 meet the statutory target amount of $20.2 billion and a potential 1% rate reduction for taxable year 2017 if net General Fund tax collections for fiscal year 2015 to 2016 meet the statutory target amount of $20.975 billion. To see whether or not the targeted collection amount has been met, prior law used the amount reported by the State Controller in the State's Comprehensive Annual Financial Report. This report contains several different reports and none of the reports necessarily reflect the collections used by the General Assembly and the Appropriations Committees when the Fiscal Research Division prepares the budget availability statement for a fiscal year. The number most commonly used by the legislature when it begins budget discussions is the amount reported by the Department of Revenue. This section clarifies that net General Fund tax collected for a fiscal year means the amount of net revenue reported by the Department of Revenue's June Statement of Collection as "Total General Fund Revenue" for the 12-month period that ended the previous June 30, modified as follows: less any large one-time, nonrecurring revenue, adjusted by any changes in net collections resulting from suspension or termination of transfers out of the General Fund. This section became effective August 7, 2014.***

- ***Modify County Hold Harmless for Repealed Local Taxes: S.L. 2014-100, Sec. 37.2 (SB 744, Sec. 37.2) modifies a hold harmless payment made to counties originally enacted in S.L. 2007-323. Under S.L. 2007-323, the State assumed the county portion of nonfederal Medicaid costs. To provide the financial resources to assume these costs, S.L. 2007-323 phased out one-half cent in local sales tax and made a corresponding increase in the State sales tax rate. S.L. 2007-323 also provided a hold harmless payment to counties equal to the counties' forgone or repealed sales tax revenue minus the Medicaid expenses that the State assumed. The payment guaranteed that every county would benefit from these changes by at least $500,000 annually. Section 37.2 of SB 744, phases out the provision that each county will benefit by $500,000 annually as follows: effective July 1, 2014, the guaranteed amount is $375,000; effective July 1, 2015, the guaranteed amount is $250,000; effective July 1, 2016, the guaranteed amount is $125,000; effective July 1, 2017, no guaranteed amount. Based on projected sales tax collections and Medicaid expenses, 24 counties will continue to receive a hold harmless payment beginning in FY 2017-18.***

Modular/Manufactured and Modular Home Sales Tax: S.L. 2014-100, Sec. 37.3 (SB 744, Sec. 37.3) exempts 50% of the sales price of a manufactured or modular home from sales tax. This section became effective September 1, 2014, and applies to sales made on or after that date.

UI FUND SOLVENCY & PROGRAM CHANGES.

Session Law	*Bill #*	*Sponsor*
S.L. 2013-2	**HB 4**	**Rep. Howard, Warren, Starnes, Setzer**

AN ACT TO ADDRESS THE UNEMPLOYMENT INSURANCE DEBT AND TO FOCUS NORTH CAROLINA'S UNEMPLOYMENT INSURANCE PROGRAM ON PUTTING CLAIMANTS BACK TO WORK.

SUMMARY: S.L. 2013-2, House Bill 4, makes the following changes to the State unemployment insurance program (UI) to accelerate[26] the repayment of the $2.5 billion advance the State borrowed from the federal government to pay UI benefits:

- ***Effective January 1, 2014, the bill makes the following tax rate changes: increase the minimum State unemployment tax (SUTA) rates from 0% to .06%, increase maximum SUTA tax rate from 5.7% to 5.76%; and compute SUTA tax rates based on a formula.***
- ***Effective July 1, 2013, the bill establishes a new trigger for the collection and suspension of the surtax, which is equal to 20% of an employer's SUTA liability.***
- ***Effective July 1, 2013, the bill requires a 1% reserve from all governmental entity and nonprofit employers that elect to finance benefits through reimbursement, and disallow refunds.***
- ***Effective, July 1, 2013, the bill restricts the use of revenues in the Employment Security Commission Reserve Fund and the Special Employment Security Administration Fund.***
- ***Effective July 1, 2013, the bill makes the following benefit changes: reduce the maximum duration of regular benefits from 26 weeks to 20 weeks and tie the duration of benefits to the seasonal adjusted unemployment rate; reduce the maximum weekly benefit amount (WBA) from $535 to $350; and change the calculation of the WBA from a formula based on the high quarter wage in the claimant's base period to the average of the last two quarters of that period.***
- ***Effective July 1, 2013, the bill restricts the optional triggers for the availability of extended benefits to those times when the benefits would be 100% federally funded. It does not change the mandatory trigger for extended benefits.***
- ***Effective July 1, 2013, the bill makes the following programmatic changes: require a waiting week for each new benefit claim; repeal substantial fault; eliminate most good cause provisions for leaving work; and redefine suitable work as any work paying 120% of weekly benefit amount after 10 weeks of benefits.***

[26] Simulations prepared by the Upjohn Institute suggest the UI Fund would have a positive credit balance in 2018 if the State did not change its laws and relied solely on federal tax increases for the payment of the debt. A simulation based on the changes proposed in the bill suggests the UI Fund would have a positive credit balance in 2015.

- ***The bill establishes a Joint Legislative Oversight Committee on Unemployment Insurance.***

BACKGROUND: The Unemployment Compensation Program is a Federal-state partnership created by the federal Social Security Act of 1935 and the Federal Unemployment Tax Act (FUTA). The purpose of the UI program is to provide economic stability to both the unemployed individual and the surrounding community. Federal law requires states to offer temporary unemployment compensation benefits to individuals who lose a job through no fault of their own and are able, available, and actively seeking work. States may design their own UI program so long as the program meets minimal federal coverage and benefit requirements. Employers pay both a federal and state unemployment tax to fund the program. No part of either tax may be deducted from an employee's wages.

The FUTA tax rate is 6% and is applied to a $7,000 taxable wage base. Employers are allowed a credit of up to 5.4% if a state's UI program complies with federal law and regulations, for an effective FUTA tax rate of 0.6% or $42 per employee. This amount is credited to the federal treasury and used to offset the costs of administering the states' UI programs.

If a state does not have sufficient revenues in its Unemployment Trust Fund to pay benefits, the federal unemployment account provides an automatic advance or loan to the state.[27] North Carolina received its first advance in February 2009. The State currently owes the federal unemployment account $2.5 billion.[28] To ensure repayment of the advance, the FUTA tax credit is reduced by 0.3% each year[29] until the debt is repaid; all of the revenue generated by the credit reduction is applied to the principal of the outstanding loan balance. The revenue cannot be used to pay the interest on the debt.[30]

The FUTA tax rate in North Carolina is currently $84 per employee.[31] Under this repayment method, the State is expected to have a positive balance in its Trust Fund account in 2018. Under the current repayment schedule, the FUTA tax rate is anticipated to be $105 per employee in 2014, $126 in 2015, $147 in 2016, $168 in 2017, and $189 in 2018 before returning to $42 in 2019.

CURRENT LAW: Chapter 96 of the General Statutes creates North Carolina's current UI program. The UI program provides coverage and benefits to the employees of private employers, State and local governments, Indian tribes, and nonprofit organizations.

Article 2 of Chapter 96 contains the financing system for UI. Under that system, private employers must pay a SUTA tax, or contribution, on the taxable wages of each of their employees. The taxable wage base in North Carolina is equal to 50% of the average

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[27] As of January 3, 2013, 20 states have an outstanding state loan from the Federal Unemployment Account.

[28] NC's debt is the 3rd largest behind California at $10.3 billion and New York at $3.5 billion.

[29] The credit reduction begins when a state has an outstanding federal loan balance 2 consecutive Januarys. The indebtedness must be eliminated by November 10th to restore the full credit for the succeeding calendar year.

[30] North Carolina has used revenue in the Employment Security Commission Reserve Fund to pay the interest payments. Interest payments are due on September 30th of each year. The interest rate is determined annually. The interest rate for 2012 was 2.9%. The interest rate for 2013 is 2.6%.

[31] The FUTA tax credit was reduced from 5.4% to 5.1% in 2012 and to 4.8% in 2013.

yearly insured wage[32] The taxable wage base for 2013 is $20,900.[33] Employers that are governmental or nonprofit organizations must be given the election to finance benefits by making reimbursement payments to the Division in lieu of paying a contribution.

The SUTA contribution rates vary from 0% to 5.7%. The revenue from the contribution is credited to the Unemployment Insurance Fund and used only to fund benefits. An employer's SUTA contribution rate is based on an experience-rated system. The Division of Employment Security, Department of Commerce (Division) annually computes an employer's experience rating based on the contribution credits made to and benefits charges made against the employer's account. A positive experience rating produces a lower SUTA contribution rate and a negative experience rating produces a higher SUTA contribution rate.

An employer who has a SUTA tax liability must also pay surtax equal to 20% of the SUTA contribution liability. The revenue from the surtax is credited to the Employment Security Commission Reserve Fund. The revenue from the surtax may be used for various purposes. It has been used to pay the interest on the outstanding advance and to supplement federal grants from US Department of Labor (US DOL) for local Employment Security Commission offices.

Article 2 of Chapter 96 also contains the benefit system for UI. An employee with an attachment to the workforce, as evidenced by sufficient earnings and duration of employment in a 15-month base period, is entitled to some UI benefits if the employee loses a job through no fault on the part of the employee. The UI system imposes a two-year disqualification for UI benefits if the Division determines an individual lost a job for reasons of misconduct[34] and it imposes lesser periods of disqualification for an individual who lost a job for reasons of substantial fault.[35] The current UI program also allows benefits to employees who leave a job for certain causes unrelated to the job such as relocation of a spouse or health of a relative.

An individual who qualifies for UI benefits is eligible for a weekly benefit amount (WBA). The individual's eligibility is determined on a week-by-week basis. To receive a weekly benefit, an individual must be able to work, available to work, and actively seeking work. An individual who is determined to be ineligible for failure to meet one or more of these work search requirements does not receive a benefit for that week. However, the individual remains eligible for benefits in the remaining weeks if the individual meets the requirements.

In addition to UI benefits for an employee who lost a job, an employee may collect UI benefits while remaining on an employer's payroll. An individual who is payroll attached is considered unemployed when the individual works less than the equivalent of three customary scheduled full-time days in the job in which the individual has payroll attachment as a regular employee. An individual who is payroll attached does not have to meet the work search requirements to be eligible to receive benefits. The individual must be able and

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[32] The average yearly insured wage = average weekly wage on August 1st divided by 52.

[33] Compared to the surrounding states of AL, FL, GA, KY, MS, SC, TN, and VA, North Carolina has the highest taxable wage base. The taxable wage base in most states is in the range of $8,000-$9,000. Data from Upjohn Institute.

[34] The two-year period may be reduced if the individual returns to work for at least five weeks, is paid cumulative wages of at least 10 times the individual's WBA, subsequently becomes unemployed through no fault, and meets the work search requirements.

[35] An individual found to be in substantial fault is disqualified for a period of nine weeks. The Division may increase or decrease this number of weeks based on aggravating or mitigating circumstances. An employer's account is not charged for benefits paid due to substantial fault.

available to return to work when recalled by the employer. Historically, attached claims account for approximately half of UI claims, although the percentage declined to 40-45% during the recent recession.

An individual's WBA is 50% of the high-quarter wages paid to the individual in the base period, not to exceed the maximum WBA. The maximum WBA is 66 2/3% of the average weekly insured wages. The Division calculates the maximum WBA on August 1st of each year. The maximum WBA for the period August 1, 2012, through July 31, 2013, is $535.

The number of weeks an individual may receive UI benefits is derived from a fraction of the individual's base period wages, with a minimum number of 13 weeks and a maximum number of 26 weeks. In addition to the regular benefit period, which is fully funded by SUTA revenue, the State may be entitled to 13 weeks of extended benefits if the unemployment rate in the State is higher than its two-year average. In some instances of very high unemployment the number of weeks of extended benefits may be as great as 20 weeks. Generally, the federal government pays 50% of the costs of providing extended benefits. During the Great Recession, the federal government fully funded the State's extended benefits. The federal funding for these benefits comes from direct appropriations, not from FUTA revenues. North Carolina triggered "off" extended benefits in May of 2012.

At times, including the recent Great Recession, Congress enacts temporary legislation providing additional weeks of Emergency Unemployment Compensation (EUC). At one point, EUC provided up to 53 weeks of additional benefits. Today, the number of weeks provided through EUC is up to 47. Congress recently extended the time for providing EUC from January 2, 2013, to January 1, 2014. A state does not have to participate in the EUC. To participate in the EUC, a state signs an agreement with the US DOL. A state may terminate the agreement with 30 days' written notice to US DOL. To participate in the current agreement, a state must not reduce the way it calculates benefits in such a way that the average weekly benefit would be less than the average weekly benefit provided by the state in June of 2010. In North Carolina today, an individual may be eligible for up to 73 weeks of benefits.[36]

SECTION-BY-SECTION BILL ANALYSIS: The policy changes to the UI program in House Bill 4 allow the State to accelerate the repayment of its $2.5 billion to the federal unemployment account by approximately three years. The accelerated repayment means the FUTA tax rate borne by NC employers would return to 0.6% in 2016 as opposed to 2019.

SECTION 1: FUND CHANGES

Substantively, section 1 restricts the use of revenue in the Employment Security Administration Reserve Fund (renamed the Unemployment Insurance Reserve Fund) to the payment of benefits, interest payment on federal advances used to pay benefits, and principal payment on federal advances used to pay benefits. Under current law, revenues in the fund may be used to fund local offices. Section 1 also caps the balance in the Fund on January 1 of any year to the greater of $50 million or the amount of interest paid the previous September on federal advances. Any amount in the Fund that exceeds this cap is transferred to the Unemployment Insurance Fund. The amount of interest paid in September 2012 on federal advances was $83.9 million.

[36] 26 weeks of regular benefits, plus 47 weeks of EUC.

Section 1 restricts the use of revenue in the Special Employment Security Administration Fund (renamed the Supplemental Employment Security Administration Fund). Under current law, revenues in the fund may be used for improvements to buildings, the enhancement of the work environment in buildings used by the Division of Employment Security, the acquisition of real estate, buildings, and equipment required for the expeditious handling of Division business, and the temporary stabilization of federal funds cash flow. The bill limits the use of money to the temporary stabilization of federal funds and to payment of costs determined by US DOL to be ineligible for payment from the Employment Security Administration Fund. The restrictions imposed by the bill on the use of money in this fund effectively limits the funds available to administer the State's UI program to the grant monies allocated to the State by US DOL.

Administratively, section 1 moves the definitions from Article 2 of Chapter 96 to Article 1 because the definitions apply throughout the Chapter. The bill puts the definitions in alphabetical order, it cross-references many definitions to their meaning under FUTA, and it removes definitions that are not needed. It renames the four funds used to administer the UI program to more clearly reflect their purpose and it removes antiquated and redundant language:

- Unemployment Insurance Fund. – The revenue for this fund consists of SUTA contributions and it is used to pay benefits. Contributions credited to the Unemployment Insurance Fund are transferred daily to the State's account in the Unemployment Trust Fund. The Trust Fund is held in the federal treasury. Money in the State's account is requisitioned by the State as needed to pay benefits. As the money is requisitioned, it is transferred to the State's Unemployment Insurance Fund to pay benefits. If the State's account in the Unemployment Trust Fund is not sufficient to meet the requisitioned amount needed to pay benefits, then the State receives an advance from the federal unemployment account.

- Unemployment Insurance Reserve Fund. – The revenue for this fund consists of surtax revenue and its use is limited by this bill to the payment of benefits and to payment of interest and principal on federal advances.

- Employment Security Administration Fund. – The revenue for this fund consists primarily of grant money allocated to the State from US DOL for the administration of the State's UI program.

- Supplemental Employment Security Administration Fund. – The revenue for this fund consists primarily of interest paid by employers on past due contributions and its use is limited by this bill to payment of costs determined by US DOL to be ineligible for payment from the Employment Security Administration Fund, temporary stabilization of federal funds cash flow, security for advances, and the repayment of an overpayment of interest previously credited to this fund.

SECTION 2: SUTA CONTRIBUTION AND SURTAX CHANGES RESERVE REQUIREMENTS FOR REIMBURSABLE EMPLOYERS

Substantively, Section 2 does the following:

- Replaces the current tax schedules with a formula.

- Increases the minimum and maximum SUTA contribution rates.

- Changes the trigger that suspends the collection of the surtax.
- Simplifies the reimbursement option for employers that are governmental and nonprofit organization by treating them uniformly. Uniformity means that all of them are required to maintain a reserve account equal to 1% of the taxable wages paid by them to their employees.

Section 2 repeals the current set of stepped tax schedules that determine an employer's SUTA contribution rate and replaces the schedules with an equation based on a reserve ratio. The change results in smoother movement between experience ratings and improves the responsiveness of the system. The contribution rate may change under the equation depending on the balance in the State's account in the federal Unemployment Trust Fund on August 1st. If the amount in the Trust Fund is less than or equal to 1% of the total wages reported by all insured employers in the State for the 12-month period ending on July 31st, then the contribution rate is 2.9% minus the employer's reserve ratio percentage (ERRP). The amount in the Trust Fund is currently less than 1% of total wages.

If the amount in the Trust Fund is greater than 1% of total insured wages but less than or equal to 1.25%, then the contribution rate is reduced to 2.4% minus the ERRP. If the amount in the Trust Fund is greater than 1.25% of total insured wages, then the contribution rate may decline to 1.9% minus the ERRP. The ERRP is the employer's reserve ratio based on the employer's experience rating. The bill does not change how an employer's experience rating is determined. The move from the stepped tax schedules to an equation may result in minor contribution changes for employers between the minimum and maximum contribution rates. The increase in contributions required from employers currently at the minimum and maximum contribution rates is attributable to the increase in the minimum and maximum rates.

Section 2 increases the minimum and maximum contribution rates; it does not change the standard beginning rate of 1%. It increases the minimum contribution rate from 0% to .06%. North Carolina is the only state with a 0% minimum tax rate. Approximately 20% of North Carolina's employers have no SUTA tax liability. Since the surtax is a percentage of SUTA liability, these employers do not have a surtax liability. Under the bill, these employers will pay some SUTA tax and consequently the surtax.[37] The bill increases the maximum contribution rate from 5.7% to 5.76%. Approximately 10% of North Carolina employers pay SUTA at the maximum rate.

Section 2 changes the trigger for determining when the surtax must be collected. Under current law, the trigger is based upon how much is in the Employment Security Commission Reserve Fund (Reserve Fund). If the amount in the Reserve Fund equals or exceeds $163,349,000 on August 1st, the collection of the surtax is suspended for the succeeding calendar year. This dollar amount represented 1% of taxable wages in 1984.[38] The bill changes the trigger from an amount in the Reserve Fund to an amount in the State's account in the Unemployment Trust Fund: the surtax would be suspended when the amount in the Trust Fund equals or exceeds $1 billion.

Section 2 simplifies the provisions applicable to employers that must be given the option to reimburse the Unemployment Insurance Fund for benefits paid on their behalf as opposed

[37] With a taxable wage base of $20,900, an employer's SUTA tax liability with a .06% rate would be $12.54 per employee and the surtax liability would be $2.51.
[38] The surtax last triggered on in 2005 and has been collected since then.

to paying contributions.[39] Under current law, most nonprofit organizations and all Indian tribes and subsidiaries of an Indian tribe that make this election must maintain a reserve account equal to 1% of the taxable wages paid to its employees. The bill imposes this same 1% reserve requirement on governmental entities, as well as all nonprofit organizations.

For governmental entities, the change essentially ensures that the funds are available in the employer's account to pay unemployment benefits when the benefits are paid. The change represents a one-time cash flow expenditure for governmental entities because not only will these entities have to pay the full reimbursement cost of benefits paid to claimants in 2012 in January of 2014, they will also have to make advance payments for the four calendar quarters beginning with the quarter that begins July 1, 2013, to build the 1% reserve. The largest quarterly advance will likely be the one made for the first quarter of the calendar year, payable in April 2014. Thereafter, governmental entities will have an annual reconciliation to maintain the 1% balance in their reserve account. The Division will determine the amount necessary to maintain the appropriate reserve balance on August 1st of each year.

Most nonprofit organizations currently maintain a 1% balance in their reserve accounts. However, some are allowed to post a surety bond or have a line of credit in lieu of the 1% reserve. This change may represent a similar cash flow issue for these nonprofits. Currently, the bonds and lines of credit are allowed for two-year periods. Effective July 1, 2013, the bill prevents a nonprofit organization from submitting a line of credit or a surety bond to secure its reimbursing election. The bill does allow current lines of credit or surety bond contracts to expire in their normal course.

Administratively, Section 2 simplifies the statutes by adopting the relevant provisions of federal law. The bill does not change coverage of employers subject to the UI program.

SECTION 3: ADMINISTRATION AND COLLECTION OF CONTRIBUTIONS

Substantively, Section 3 allows the Secretary of Commerce to compromise an employer's liability under the same limited circumstances that the Secretary of Revenue has to compromise a tax liability. When the Secretary compromises an employer's liability and the liability is at least $1,000, the Secretary must make a written statement that sets out the amount of the liability, the amount accepted under the compromise, a summary of the facts concerning the liability, and the findings on which the compromise is based.

Administratively, Section 3 consolidates the provisions concerning the administration and collection of contributions in one Article. It does not change the current law.

SECTION 4: ADMINISTRATION OF EMPLOYER ACCOUNTS

Substantively, Section 4 greatly reduces the number of reasons for which an employer may be relieved from having benefits charged against the employer's account. This change conforms to the benefit changes made in Section 5, and more fully explained in that section of the summary.

Section 4 also amends the penalty enacted last session that prohibits the release of charges when an overpayment is made to a claimant because the employer failed to respond timely to a request for information concerning the claim. To comply with federal law, a state must impose this penalty as part of its UI program, effective on or before October 21, 2013. The penalty applies to employers that have exhibited a pattern of failing to respond.

[39] FUTA requires states to give governmental and nonprofit employers a reimbursement option.

Section 4 defines a "pattern of failing" by providing that a pattern cannot be found unless the employer failures during the year prior to the request is less than 2% of the total requests made to that employer. It also moves the effective date of this provision from October 1, 2013, to October 21, 2013, the date required by federal law.

Administratively, Section 4 consolidates the provisions concerning how and when contributions are credited to an employer's account and how and when benefit charges are credited against an employer's account. It also requires an employer with 25 or more employees to file the Quarterly Tax and Wage Report electronically. Under current law, the electronic filing requirement applies to an employer with 100 or more employees.

SECTION 5: PAYMENT OF BENEFITS

Substantively, Section 5 does the following:

- Requires a waiting week for each claim filed.
- Eliminates and modifies many of the reasons for which a claimant may qualify for benefits and changes the terms of the disqualification.
- Changes the calculation for how an individual's WBA is determined; reduces the maximum WBA to a statutorily set amount of $350; and changes the calculation for an individual's partial WBA.
- Reduces the maximum duration of regular UI benefits and limits the applicability of optional extended benefits.
- Redefines "suitable work".
- Places additional benefit limitations on company officers and spouses of company officers.

Waiting week.

To obtain benefits, an individual must file a valid claim for unemployment benefits and register for work. The bill requires an individual to wait a week for each claim filed before receiving a benefit. Under current law, the waiting week is limited to one per benefit year. A valid claim is one that meets certain employment and wage standards. The bill does not change those standards:

- An individual must have been paid wages in at least two quarters of the base period.
- An individual must have been wages totaling at least six times the average weekly insured wage during the base period, which is the first four of the last five completed calendar quarters. If the individual does not have sufficient base period wages, the alternative base period is the last four completed quarters.

Qualification changes.

For an individual that files a valid claim, the Division must determine whether the individual qualifies for benefits. Qualification for benefits is determined based on the reason for separation from employment. The bill makes the following qualification changes:

- Reduced work hours. – An individual may qualify for benefits if the individual's work hours have been reduced by more than 50% as part of a unilateral and permanent

reduction of work hours. Under current law the reduction in work hours need only be 20%.[40]

- Disciplinary suspension. – An individual may qualify for benefits if the individual has been placed on disciplinary suspension for more than 30 consecutive days. Under current law the suspension need only be for 10 consecutive days. The issue becomes whether the reason for suspension is a disqualifying reason for benefits.

- Good cause.[41] – The bill eliminates all but two of the reasons for which an individual could voluntarily quit work and still qualify for UI benefits. Those two reasons are domestic violence and military spousal relocation.[42] The reasons eliminated include: bankruptcy; impending closure; spousal relocation; disability or other health concern, whether or not it is related to work; disability or health concern of minor child, aged or disabled parent, or disabled immediate family member; inability to accept work during a particular shift because of concerns related to child care, elder care, or care of a disabled family member.

- Substantial fault.[43] – The bill eliminates substantial fault. Under substantial fault, an individual may qualify for a reduced number of weeks of UI benefits if the reason for separation included fault on the part of the individual, but the fault did not rise to the level of misconduct. Under the bill, an individual would either qualify for benefits, or not qualify; there would be no qualifying for a reduced number of weeks of benefits.

In addition to the reasons given above for disqualification of benefits, an individual may be disqualified for leaving work without good cause attributable to the employer, for misconduct, or for failing to secure the necessary licenses, permit, bond, or surety required for the job. The length of the disqualification period may be two years, or it may be less. The current law gives the Division a lot of discretion in defining the length of the disqualification. The bill would remove this discretion. An individual would either qualify for the full duration of benefits, or not qualify for the benefits at all. And if an individual is disqualified for benefits, the disqualification only applies to that claim.

Weekly benefit amount.

The Division must determine the WBA and the duration of benefits a qualifying individual is entitled to receive. The bill makes the following changes in the calculation of the WBA:

- Changes the calculation of the WBA from 50% of the individual's high-quarter wages in the base period, not to exceed the maximum WBA, to 50% of the individual's average weekly wage in the last two quarters of the base period. [44] North Carolina's average weekly benefit (AWB) for 2011 was $291.[45] The Upjohn Institute report noted that wages for the two quarters immediately preceding unemployment were typically 66.4% of the high-quarter wages. Based on that

[40] The bill does not change the 15% reduction of work pay as a reason for qualifying for benefits if the reduction is part of a unilateral and permanent reduction of work pay.

[41] Benefits not charged to employer's account.

[42] An individual that qualifies for benefits under this section would still need to meet the work search requirements to be eligible for a benefit.

[43] Benefits not charged to employer's account.

[44] The methods states use to determine WBA vary greatly. At least half of the states use the high-quarter method. Other methods used include: multi-quarter, annual wage, average weekly wage formula.

[45] That amount was slightly higher than the AWB in the surrounding states of AL ($204), FL ($232), GA ($268), KY ($287), MS ($191), SC ($238), TN ($238), and VA.

assumption, this change is expected to reduce aggregate UI benefits by 33.6%. The actual number of claimants impacted is indeterminable; it would impact any individual whose quarterly wages are reduced in the two quarters preceding an unemployment claim.

- Sets the maximum WBA in statute at $350.[46] Currently, the Division calculates the maximum WBA annually based on 66 2/3% of the average weekly insured wages on August 1; the maximum WBA in the State today is $535.[47] An estimated 21.7% of weekly claims checks exceed $350; of those, approximately 17% are at the maximum amount. North Carolina's maximum WBA is 70% higher than the average of the following eight states compared in the Upjohn Institute report for 2011: AL ($265), FL ($275), GA ($330), KY ($415), MS ($235), SC ($326), TN ($275), and VA ($378).
- Changes the base for determination of the disregard for partial earnings from 10% of the individual's AWW in the high-quarter to 20% of the individual's WBA.

Duration of regular benefits.

The duration of regular benefits in North Carolina ranges from 13 weeks to 26 weeks[48] depending upon the total benefit amount the individual is entitled to receive. The bill ties the duration of regular benefits to the seasonal adjusted statewide unemployment rate, as determined by the US DOL. The duration could change twice a year: January 1 and July 1. The bill also reduces the maximum number of weeks from 26 to 20.[49] Based on these two changes, the duration of benefits would vary as follows:

Seasonal adjusted UI rate	Minimum number of weeks	Maximum number of weeks
Less than or equal to 5.5%	5	12
Greater than 5.5% up to 6%	6	13
Greater than 6% up to 6.5%	7	14
Greater than 6.5% up to 7%	8	15
Greater than 7% up to 7.5%	9	16
Greater than 7.5% up to 8%	10	17
Greater than 8% up to 8.5%	11	18

[46] An individual annual wages would need to be $36,400 to qualify for a maximum benefit of $350.

[47] An individual's annual salary would need to be $55,640 to receive the maximum benefit of $535.

[48] The average duration of regular UI benefits in December 2012 was 16.3 weeks. The exhaustion rate for North Carolina for the 3rd quarter of 2012 was 54.2%. The highest exhaustion rate was 63.9% in the 2nd quarter of 2010 and the lowest was 12.5% in the 1st quarter of 1989.

[49] Upjohn Institute reports that from 2006-2011, 43% of claimants exhausted their maximum eligibility of 26 weeks. During that time period, 43% of claimants would have been affected by a reduction in the number of weeks.

Greater than 8.5% up to 9%	12	19
Greater than 9%	13	20

Weekly certification.

Once an individual qualifies for UI benefits, the individual must meet weekly work search eligibility requirements to receive the benefit. The individual must submit a certification each week attesting that the individual meets the work search requirements. If an individual does not meet the eligibility requirements, the individual is ineligible to receive a benefit until the reason for the ineligibility ceases to exist. The work search requirements are that the individual must be able to work, available to work, actively seeking work, and accepting suitable work. The Department of Commerce has made some administrative changes in this area, and the bill makes some statutory changes in it.

Last biennium[50] the General Assembly enacted legislation to place the Employment Security Commission as a division under the Department of Commerce. Through the merger process, the Division of Employment Security and the Division of Workforce Solutions have agreed in a Memorandum of Understanding (MOU) executed in November 2012 as to how each division will support the common goal of serving UI claimants who are in need of financial and job-seeking assistance. As part of that MOU, claimants will be encouraged to file UI claims remotely. The Division of Workforce Solutions will be the lead division that assists UI claimants with job search, retraining, and other support. As part of the re-employment goals, new UI claimants will be required to have an in-individual interview with someone from the Division of Workforce Solutions within the first four weeks of receiving an initial UI benefit. The purpose of the individual visit is to verify the claimant's work search, schedule claimants to participate in an employability assistance process, and identify those claimants that need subsequent on site employability interviews. If an individual fails to come, the individual's UI benefit may be stopped.

The bill makes the following statutory changes in the work search requirements:

- It defines "suitable work" as any job paying 120% of the individual's WBA after the first 10 weeks of benefits.
- It eliminates the part-time suitable work exception. Under current law, if an individual is unemployed from a part-time job, the individual is not required to accept full-time employment.
- Under current law, an individual is considered to meet the work search requirements if the individual is in school. The bill restricts this provision by limiting it to enrollment in a training program approved by the Division, as required under FUTA.

Lastly, the bill places additional benefit restrictions on company officers and spouses of company officers. Under current law, an individual is disqualified from receiving benefits if the individual is self-employed and can reasonably return to work. Also, an individual or the individual's spouse is disqualified from receiving benefits if the individual is unemployed because the individual's ownership share of the employer was voluntarily sold and the individual held 5% or more of the outstanding shares of voting stock, or was a partner, or was the sole proprietor. Under the bill, a corporate officer that qualifies for benefits would be limited in the duration of benefits to six weeks.

[50] SL 2011-145 and SL 2011-401.

Administratively, Section 5 consolidates the provisions concerning benefits in one Article. Except as otherwise noted in the summary, it does not intend to change the other provisions of current law.

SECTION 6: EXTENDED BENEFITS

Under federal law, a state must offer extended benefits during times of high unemployment in the state.[51] Extended benefits are typically funded 50% by the State and 50% by the federal government. Federal law sets one definition of high unemployment that a State must follow. It also provides optional definitions that may trigger extended benefits earlier than the mandatory definition. North Carolina's current law includes both the required trigger and the optional triggers.

The duration of extended benefits is typically equal to 50% of the total amount of regular benefits. By limiting the number of weeks of regular benefits, the bill indirectly reduces the number of extended benefits an individual may receive. Section 7 of the bill would also make one other change to the applicability of extended benefits in North Carolina by providing that the optional triggers would not "trigger on" unless the federal government has agreed to pay 100% of those extended benefits.

SECTION 7: ADMINISTRATION OF BENEFITS

Substantively, Section 7 does two things:

- It changes the administration of UI benefits by limiting the ability of employers to file attached claims on behalf of their employees.
- It authorizes the Division to collect fraudulent overpayments through attachment and garnishment.

Under current law, an employer may file a claim for an employee that it intends to keep on its payroll. That employee must be able to work for the employer and available to return to work for that employer whenever that employer calls the individual back to work. Otherwise, the employee does not have to meet the weekly certification requirements of engaging in work search efforts.

Historically, attached claims account for approximately half of UI claims, although the percentage declined to 40-45% during the recent recession. Although it is difficult to determine what employers file attached claims, it appears that those most likely to do are the employers engaged in manufacturing and construction. It also appears that a large amount of the current indebtedness can be attributed to employers who have reached the maximum contribution rate and that those employers may be largely related to manufacturing and construction. With the current limitations on the computer capabilities at the Division, a more accurate analysis is not available.

Some attached claims are filed for one or more weeks of unemployment. Under the regulations previously issued by the Employment Security Commission[52] an employer that files attached claims for one or more weeks must furnish the Division with a definite date when work will become available for the claimant. This period may not extend for more than six weeks unless the time period is extended by the local office.

Other attached claims are filed for days within a week. For example, an individual employed by a company that builds roads may file attached claims for employees when the weather outside prohibits work for less than three customary scheduled full-time days

[51] North Carolina "triggered off" extended benefits in May 2012.

[52] Regulation 10.15 and 10.16.

during the work week. This unemployment is known as partially unemployed. Under current law, an individual who is partially unemployed must serve one waiting week per benefit year. Under the bill, a claimant must serve a waiting week for each claim. That change effectively eliminates partially unemployed claims.

Under the bill, only certain employers will be allowed to file attached claims, and there are restrictions on how those claims are processed:

- Only employers that have a positive account balance would be allowed to file attached claims. If an employer that wished to file an attached claim had a negative account balance, the employer would have to make a voluntary contribution to the Unemployment Insurance Fund in an amount sufficient to bring its account balance to zero or better.
- An employer would have to immediately reimburse the Unemployment Insurance Fund for the full cost of UI benefits paid to the employee through the attached claim.
- An employer could only file an attached claim once a year for each employee, and the duration of the attached claim could not extend beyond six weeks.

Section 7 adds attachment and garnishment to the collection tools available to the Division to recover fraudulent overpayments. The Division requested this ability. A fraudulent overpayment is one that is made based on a finding that the claimant, or another individual acting in the claimant's behalf and with the claimant's knowledge, has knowingly made a false statement or representation or failed to disclose a material fact for the purpose of obtaining or increasing an unemployment benefit.
Administratively, Section 7 consolidates the provisions governing the administration of UI benefits in one Article.

SECTION 8: LOCAL OFFICES

The US DOL allocates grant money to the State to administer the UI program. Some of this grant money may be used to operate local offices. The State has historically appropriated money from the Employment Security Administration Reserve Fund to finance additional local offices. The amount appropriated in the past to fund local offices has been $19.5 million. North Carolina currently operates 90 local offices. By comparison, South Carolina operates 56 and Virginia operates 39. Section 1 of the bill restricts the use of the money in the Unemployment Insurance Reserve Fund so that continued appropriations may not be made from that fund to finance local offices. The restriction may result in the consolidation of local offices. Section 8 of the bill sets general parameters the Department of Commerce must consider as it determines the appropriate number and location of local offices.

SECTION 9: CONFORMING CHANGES

Section 9 makes conforming changes to other statutes.

SECTION 10: JOINT LEGISLATIVE OVERSIGHT COMMITTEE ON UNEMPLOYMENT INSURANCE

Section 10 establishes a Joint Legislative Oversight Committee on Unemployment Insurance. The Committee consists of eight members, four appointed by the Speaker of the House of Representatives and four appointed by the President Pro Tempore of the Senate. The Committee expires in 10 years. The Committee is authorized to do the following:

- Study the unemployment insurance laws and the administration of those laws.

- Review the State's unemployment insurance laws to determine which laws need clarification, technical amendment, repeal or other change to make the laws concise, intelligible, and easy to administer.
- Monitor the payment of the debt owed by the Unemployment Insurance Trust Fund to the federal unemployment account.
- Review and determine the adequacy of the balances in the Unemployment Trust Fund and the Unemployment Insurance Reserve Fund.
- Study the workforce development programs and reemployment assistance efforts of the Department of Commerce.

SECTION 12: EFFECTIVE DATE[53]

The bill would become effective July 1, 2013. Changes made by the act to unemployment benefits apply to claims for benefits filed on or after July 1, 2013.[54] Changes made by the act to require an account balance by an employer that is a governmental entity or a nonprofit organization and that elects to finance benefits by making reimbursement payments in lieu of contributions apply to advance payments payable for calendar quarters beginning on or after July 1, 2013. Changes made by the act to the determination and application of the contribution rate apply to contributions payable for calendar quarters beginning on or after January 1, 2014.

IRC UPDATE.

Session Law	*Bill #*	*Sponsor*
S.L. 2013-10	**HB 82**	**Representative Howard**

AN ACT TO UPDATE THE REFERENCE TO THE INTERNAL REVENUE CODE AND TO DECOUPLE FROM CERTAIN PROVISIONS OF THE FEDERAL AMERICAN TAXPAYER RELIEF ACT OF 2012.

SUMMARY: Session Law 2013-10 does the following:

- ***Updates from January 1, 2012, to January 2, 2013, the reference to the Internal Revenue Code used in determining certain State tax provisions, thereby incorporating and conforming to many of the provisions contained in the American Taxpayer Relief Act of 2012 (ATRA)[55] to the extent North Carolina law tracks those provisions, including:***
    - ***15-year depreciation schedule for leasehold, restaurant, and retail property***
    - ***Modified limitations on itemized deductions***
    - ***Student loan interest deduction***

[53] The bill section numbers inadvertently omitted a Section 11.

[54] Congress extended the Emergency Unemployment Compensation program (EUC) from January 2, 2013, to January 1, 2014, in the *American Taxpayer Relief Act of 2012*. The program provides claimants up to 47 additional weeks of benefits, financed by an appropriation from the federal government. A state's participation in the program is optional. North Carolina is currently a party to the agreement. The State can terminate the agreement with 30 days' notice. To participate in the agreement, a state cannot change the mathematical formula used to determine weekly benefit amounts in a manner that will result in the average WBA being less than the average WBA was in June 2010. The bill would violate this "non-reduction" rule, effective July 1, 2013.

[55] The federal legislation made many other changes that are not discussed in this Analysis because they either had no or minimal impact on North Carolina taxable income.

- ***Income exclusion for employer-provided educational assistance programs***

- ***Decouples from ATRA enhancements or extensions to the following provisions for the 2013 tax year:***
  - ***Bonus depreciation***
  - ***Section 179 expensing (for both 2012 and 2013)***
  - ***Qualified tuition and expenses deduction***
  - ***Mortgage insurance premium as interest deduction***
  - ***Income exclusion for discharge of residence indebtedness***
  - ***Income exclusion for IRA distributions to charity by a person who has attained age 70.5.***

- ***Adjusts the following three tax credits that were enhanced by ATRA to achieve revenue neutrality:***
  - ***Work Opportunity credit***
  - ***Earned Income credit***
  - ***Adoption credit***

PRIOR LAW: North Carolina's tax law tracks many provisions of the federal Internal Revenue Code by reference to the Code.[56] The General Assembly determines each year whether to update its reference to the Code.[57] Updating the reference makes recent amendments to the Code applicable to the State to the extent that State law previously tracked 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. Maintaining conformity with federal tax law simplifies tax reporting because a taxpayer will not need to account for differing federal and State treatment of the same asset. Prior to the passage of this legislation, the reference to the Code was January 1, 2012.

BACKGROUND: On January 2, 2013, the American Taxpayer Relief Act of 2012 (ATRA) was signed into law[58] and made substantial changes to the tax code. ATRA was intended to avert the anticipated "fiscal cliff" due to the sunset provisions scheduled to take effect in 2013 that would have ended the Bush-era tax cuts contained in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA), which were temporarily extended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (2010 Tax Relief Act).

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[56]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.

[57]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."

[58] P.L. 112-240.

ANALYSIS:

Update IRC Reference Date

Section 1 of the act updates the reference to the Code from January 1, 2012 to January 2, 2013, the date that ATRA became law. In doing so, North Carolina conforms to the following provisions:

- 2-year extension of the 15-year depreciation schedule for leasehold, restaurant, and retail property.[59]
- Permanent repeal of the limitation on itemized deductions for filers with incomes below $300,000 (MFJ) and application of the limitation for filers with incomes over $300,000.[60]
- Permanent increased phaseout ranges and elimination of the 60-month rule for the student loan interest deduction.[61]
- Permanent income exclusion for employer-provided educational assistance programs.[62]

Bonus Depreciation

Section 2 of the act does not conform to the one-year extension of the 50% bonus depreciation provision for property placed in service before January 1, 2014. The act decouples in the same manner that has been done in the past. A taxpayer is required to add back 85% of the accelerated depreciation amount in the year it is claimed for federal purposes with a corresponding 20% deduction over the next five years. The taxpayer will be deducting the same amount of an asset's basis under State law as under federal law, it

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[59] If the provision had not been extended, this property would have been subject to a 39-year recovery period.

[60] Generally, taxpayers itemize deductions if their total deductions are more than the standard deduction amount. Since 1991, the amount of itemized deductions a taxpayer may claim has been reduced by 3% of the amount by which the taxpayer's AGI is above a certain amount. This limitation is known as the Pease limitation. EGTRRA repealed the Pease limitation on itemized deductions for 2010. The 2010 Tax Relief Act extended the repeal through 2012. ATRA permanently repeals the Pease limitation on incomes at or below $250,000 for individual filers and $300,000 for MFJ for tax years beginning after December 31, 2012. ATRA reinstates the limitations for individual filers over $250,000 and for MFJ with AGI over $300,000 beginning in 2013. The deduction phaseout will equal 3% of the taxpayer's AGI over that threshold, although the total phaseout is capped at 80% of the total deductions claimed. If ATRA had not been enacted, the applicable threshold for 2013, as adjusted for inflation, would have been $178,150 for MFJ filers.

[61] Certain individuals who have paid interest on qualified education loans may claim an above-the-line deduction for interest expenses up to $2,500. Prior to 2001, this benefit was only allowed for 60 months and phased-out for taxpayers with income between $40,000 and $55,000 ($60,000 and $75,000 for joint filers). EGTRRA eliminated the 60-month rule and increased the income phase-out range from $40,000-$55,000 to $50,000-$65,000 ($100,000 and $130,000 for joint filers), with adjustments for inflation. ATRA permanently extends these changes for taxable years beginning after December 31, 2012.

[62] An employee may exclude from gross income up to $5,250 for income and employment tax purposes of employer-provided education assistance. Prior to 2001, this incentive was temporary and only applied to undergraduate courses. EGTRRA expanded this provision to graduate education. ATRA makes these changes permanent for taxable years beginning after December 31, 2012.

is just that the timing of the deduction differs. If North Carolina had conformed to this provision, the cost would have been approximately $140 million in FY 12-13 and $141 in FY 13-14.

Explained. – Businesses may depreciate the cost of a new asset[63] over a period of time, usually five to 15 years. Bonus depreciation allows a business to claim more of a deduction up front and spread the remainder out over the normal depreciation schedule.

Federal Background. – Since 2002, businesses have been authorized to take an additional depreciation deduction on depreciable property ranging from 30% to 100%, known as bonus depreciation. Most recently, the 2010 Tax Relief Act authorized 100% bonus depreciation for investments placed in service after September 8, 2010, and before January 1, 2012. It also provided 50% bonus depreciation for qualified property placed in service after December 31, 2012, and before January 1, 2013. ATRA extends the 50% bonus depreciation provision for one year.

North Carolina Background. – Since 2002 and through 2012, North Carolina has decoupled from the federal bonus depreciation provisions in the same manner as under this act.

Section 179 Expensing

Section 3 of the act does not conform to the enhanced section 179 expensing provision for 2012 or 2013. For tax year 2012, the deduction and investment limits are $250,000 and $800,000, respectively. For tax year 2013, the deduction and investment limits are $25,000 and $200,000, which is what the limits would have been at the federal level if ATRA had not been enacted.[64]

The act further provides that the property's basis will be the same for federal and State purposes and treats the difference in the same manner as State tax law has historically treated the bonus depreciation: A taxpayer must add back 85% of the additional

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[63] One important difference between bonus depreciation and section 179 expensing is that bonus depreciation applies only to new equipment, while section 179 expensing may apply to new and used equipment.

[64] Drafting error has resulted in some confusion regarding this provision. Part of the error was not identified until after the conclusion of session and need to be corrected in the 2014 Session. The intended deduction and investment limits were supposed to be $125,000 and $500,000 for tax year 2012 and $25,000 and $200,000 for tax year 2013. These would have been the federal limits for those tax years if ATRA had not been enacted. However, S.L. 2013-10 mistakenly referred to the IRC as it existed on May 1, 2010, for purposes of determining the section 179 deduction and investment limits. As of May 1, 2010, the deduction and investment limits were $250,000 and $800,000. Since the act became law on March 13, 2013, in the middle of the 2012 filing season, the General Assembly could not retroactively change the provision with respect to the 2012 tax year. Therefore, the deduction and investment limits for tax year 2012 are $250,000 and $800,000 to the extent those were the federal limits as of May 1, 2010.

Each year, the General Assembly enacts legislation that makes technical, clarifying, and administrative changes to the tax laws. This year, those changes were enacted in S.L. 2013-414, and it was the logical vehicle to correct the section 179 provision. The Department of Revenue suggested putting the limits in the statute rather than referencing the Code so that the legislative intent would be clearer. Therefore, the act removed the May 1, 2010, date and replaced it with a listing of the limits for the respective tax years. Unfortunately, an additional error was made with regard to the 2013 tax year by stating $125,000 as the phase-out amount rather than the $200,000 figure as intended. The necessary clarification should be made next session.

expensing taken under federal law in 2012 and 2013 and then deduct 20% of this amount over the succeeding five years. Full conformity to the section 179 expense deduction would have been $38 million in FY 12-13 and $22 million in FY 13-14.

Explained. – Section 179 of the Code allows the expensing of the purchase price of some business assets[65] in the year of purchase rather than taking depreciation[66] throughout the life of the asset. In other words, expensing trades a smaller yearly deduction over time for a larger deduction in year one. Use of the allowance has two components: a deduction limit and a phaseout threshold. The deduction limit is the maximum amount of the deduction that the taxpayer may elect to take. The phaseout threshold is the maximum amount that can be spent on equipment before the deduction begins to be reduced. The deduction is reduced, dollar for dollar, by the amount that exceeds the threshold. Prior to 2010, section 179 was commonly thought to apply to small businesses because of its maximum deduction and investment limits.[67] However, the enhancements made by the Small Business Jobs Act of 2010 (2010 Jobs Act) were the most expansive ever enacted and those limits have been extended under ATRA.

Federal Background. – The 2010 Jobs Act increased the deduction limit for tax years 2010 and 2011 from $250,000 to $500,000 and increased the phaseout from $800,000 to $2 million. The 2010 Jobs Act also broadened the definition of qualified property to include qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property, and computer software. These enhancements were set to expire for the 2012 taxable year with the limits reverting to prior levels of $25,000 and $200,000.

The 2010 Tax Relief Act did not extend the types of property that qualify for the deduction beyond the 2011 taxable year, but it increased the limits for taxable year 2012 to $125,000, adjusted for inflation ($139,000) and $500,000. Under the 2010 Tax Relief Act, the deduction limits were set to revert to their prior levels of $25,000 and $200,000 in 2013.

ATRA increases the section 179 limitations for tax years 2012 and 2013 to the same limitations that applied to 2010 and 2011 and extends the qualified real property allowance through 2013. Qualified property generally consists of qualified leasehold property, restaurant property, and retail improvement property. Taxpayers can deduct up to $500,000 of section 179 property for tax years beginning in 2012 and 2013 with a $2 million phaseout. If ATRA had not been enacted, the federal limits under section 179 would have been $125,000 and $500,000 for 2012 and $25,000 and $200,000 for 2013.

The special rule allowing off-the-shelf computer software to be subject to section 179 expensing was scheduled to expire for software placed in service after 2012. ATRA extended the expensing of such software for another year. Thus, off-the-shelf software placed in service in 2013 is subject to the section 179 expensing election.

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[65] The business asset must be newly purchased tangible personal property that is used more than 50% for business purposes and is eligible to be depreciated under the Code. The newly purchased property may be new or used equipment.

[66] Generally, taxpayers take the Section 179 expensing deduction first and claim bonus depreciation on any remaining basis.

[67] Prior to the Emergency Economic Stabilization Act of 2008 (EESA), deduction limit was $125,000 with a phase-out beginning at $500,000.

North Carolina Background. – Prior to 2010, North Carolina typically conformed to the enhanced section 179 expense deduction provisions. However, given the expansive nature of the enhancements made by the 2010 Jobs Act, North Carolina decoupled by maintaining the limits of $250,000 and $800,000 for taxable years 2010 and 2011. North Carolina conformed to the expanded definition of qualified property in 2011.

Work Opportunity Tax Credit

Section 4 of the act conforms to the extension of the work opportunity tax credit under ATRA, but it adjusts the North Carolina credit amount from 6% to 3% for the 2013 tax year to achieve revenue neutrality.

Explained. – The federal work opportunity tax credit is available to employers that hire individuals from the targeted groups listed below. The amount of the credit is generally 40% of the qualified worker's first-year wages up to $6,000.[68] The targeted groups are:

- Qualified individuals in families receiving certain government benefits, including Title IV-A social security benefits (aid for dependent children) or food stamps
- Qualified individuals who receive supplemental social security income or long-term family assistance
- Veterans who are members of families receiving food stamps, who have service-connected disabilities, or who are unemployed
- Designated community residents
- Vocational rehabilitation referrals certified to have physical or mental disabilities
- Qualified summer youth employees who live in empowerment zones, enterprise communities, or renewal communities
- Ex-felons hired no more than one year after the later of their conviction or release from prison

Federal Background. – The credit was scheduled to terminate in 2012 for wages paid to all targeted individuals, except for qualified veterans. The credit as it applies to wages paid for qualified veterans was scheduled to terminate in 2013. ATRA extended the credit for all groups for two-years through 2013.

North Carolina Background. – North Carolina provides a State income tax credit to a taxpayer who is allowed a work opportunity tax credit under the Internal Revenue Code. The amount of the credit is equal to 6% of the amount of credit allowed under the Code.[69] The credit is set to expire January 1, 2014.

Deduction for Qualified Tuition and Related Expenses

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[68] $3,000 for summer youths and $12,000, $14,000, or $24,000 for qualified veterans, providing certain requirements are met. For long-term family aid recipients, the credit is equal to 40% of the first $10,000 in qualified first year wages and 50% of the first $10,000 of qualified second-year wages.

[69] The credit may be claimed against the franchise tax or the income tax. The taxpayer must elect the tax against which a credit will be claimed when filing the return; the election is binding. The credit allowed may not exceed 50% of the tax against which it is claimed. Any unused portion of the credit may be carried forward for five years.

Section 5 of the act conforms to the federal enhancements of the qualified tuition and expenses deduction for tax year 2012, but not for tax year 2013. For tax year 2013, a taxpayer will be required to add back the amount of the deduction taken at the federal level for purposes of determining North Carolina taxable income. If North Carolina had conformed to this provision, the cost would have been approximately $6 million in FY 13-14.

Explained. – Subject to income limitations, a taxpayer may take an above-the-line deduction for qualified education expenses paid during the year for the taxpayer or the taxpayer's spouse or dependents. Generally, any accredited public, nonprofit, or proprietary post-secondary institution is an eligible educational institution. The maximum deduction is $4,000 for an individual whose adjusted gross income for the tax year does not exceed $65,000 ($130,000 for MFJ filers), or $2,000 for other individuals whose adjusted gross income does not exceed $80,000 ($160,000 for MFJ filers).

Federal Background. – This deduction was established under EGTRRA and was scheduled to expire in 2006. It was subsequently extended through 2011. ATRA extends the deduction for two more years through 2013.

North Carolina Background. – North Carolina has previously conformed to this provision.

Section 5(b) disallows, for tax year 2013, the State deduction for taxpayers who opted to claim the Hope scholarship credit, the Lifetime Learning credit, or the American Opportunity tax credit in lieu of the federal deduction for tuition and fees.

At the federal level, a taxpayer may opt to claim one of the three above-named credits in lieu of the deduction for tuition and fees. A taxpayer who does so is eligible to claim a deduction on the North Carolina tax return for the tuition and fees deduction they forfeited on the federal return that they would have otherwise been entitled to claim had they not chosen to take one of the federal credits. By disallowing the State deduction, taxpayers are treated similarly regardless of whether they elected the federal credit or the federal deduction. Otherwise, a taxpayer who claims the federal deduction would get no State tax benefit (to the extent this act requires an addback for that deduction) while those who claim the federal credit would be entitled to the State tax deduction.

Income Exclusion for Distributions from IRAs to Charity

Section 6 of the act does not conform to the extension of the income exclusion for a qualified charitable distribution from an individual retirement plan by a person who has attained the age of 70½ for tax year 2013. It requires a taxpayer to add back the amount excluded at the federal level for purposes of determining North Carolina taxable income. If North Carolina had conformed to this provision, the cost would have been approximately $3 million in FY 13-14.

Explained. – Generally, a taxpayer must include in gross income distributions made from a traditional or Roth IRA account except to the extent they represent a return of nondeductible contributions or are rolled over into another qualified retirement plan.

Federal Background. – Since 2006,[70] taxpayers age 70½ or older may contribute up to $100,000 from their IRA account to a charity tax-free. This income exclusion was set to expire for distributions made in tax years beginning after December 31, 2011. ATRA

[70] This exclusion was originally authorized by the Pension Protection Act of 2006. The law was extended through 2009 by the Emergency Economic Stabilization Act of 2008, and through 2011, by the 2010 Tax Relief Act.

extends the availability of this exclusion for two years for distributions made in tax years beginning in 2012 and 2013.

North Carolina Background. – North Carolina has previously conformed to this provision.

Section 6(b) would allow a taxpayer age 70½ or older to take a charitable deduction for the donation of an IRA distribution to charity to the extent the taxpayer was required to add back the amount excluded from gross income at the federal level.

At the federal level, a taxpayer may not get a double benefit for donating an IRA distribution to charity by both excluding it from income and taking the charitable deduction. A taxpayer may elect one but not both. If a taxpayer elects to take the 170 charitable deduction at the federal level, the deduction would flow through for North Carolina purposes.[71] However, if a taxpayer elects the income exclusion, there would be no benefit at the State level because, under this act, a taxpayer is required to add that amount back. Therefore, this section allows the taxpayer to take a charitable deduction for that contribution.

Income Exclusion for Discharge of Qualified Principal Residence Indebtedness

Section 7 of the act does not conform to the extension of the income exclusion for the discharge of qualified principal residence indebtedness. It requires a taxpayer to add back the amount excluded at the federal level for purposes of determining North Carolina taxable income. If North Carolina had conformed to this provision, the cost would have been approximately $8 million in FY 13-14.

Explained. – Taxpayers are generally required to recognize income from the discharge of indebtedness. An exception from this rule is for the discharge of qualified principal residence indebtedness, which has been excludible from gross income on a temporary basis since 2007.[72] The exclusion is limited to $2 million, and applies to indebtedness incurred in the acquisition, construction, or substantial improvement of a principal residence and secured by the residence.

Federal Background. – This exclusion was scheduled to expire for debt discharged after December 31, 2012, but was extended for one year under ATRA.

North Carolina Background. – North Carolina has previously conformed to this provision.

Deduction for Mortgage Insurance Premiums as Interest

Section 8 of the act conforms to the extension of the deduction for mortgage insurance premiums as interest for tax year 2012, but not for tax year 2013. Therefore, taxpayers are required to add back the amount they took as a deduction at the federal level for purposes of determining North Carolina taxable income. If North Carolina had conformed to this provision, the cost would have been approximately $6 million in FY 13-14.

Explained. – Generally, taxpayers may not deduct any interest paid or accrued during the tax year that is considered personal interest. This restriction does not apply to certain types of interest, including qualified residence interest. Qualified residence interest includes interest on home acquisition indebtedness of up to $1 million and interest on home equity indebtedness of up to $100,000. In the case of a home acquisition loan, an individual who cannot pay the entire down payment amount may be required to purchase mortgage insurance.

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[71] Nonitemizers may take the credit under G.S. 105-151.26.

[72] This exclusion was originally authorized in the Mortgage Debt Relief Act of 2007.

Federal Background. –Since 2006, premiums paid for qualified mortgage insurance in connection with acquisition indebtedness for a qualified residence are treated as qualified residence interest and are deductible.[73] The treatment of qualified mortgage insurance as qualified residence interest was set to expire for amounts paid or accrued after December 31, 2011. ATRA extends the availability of the deduction for two years through 2013.

North Carolina Background. – North Carolina has previously conformed to this provision.

Earned Income Tax Credit

Section 9 of the act conforms to changes made under ATRA to the earned income tax credit, but it adjusts the North Carolina credit amount from 5% to 4.5% for the 2013 tax year to achieve revenue neutrality.

Explained. – The EITC is a refundable tax credit for working low to moderate income families that varies depending on the number of the taxpayer's qualifying children.

Federal Background. –EGTRRA made a number of changes to simplify the credit and to reduce the marriage penalty experienced by married taxpayers claiming the credit. The American Recovery and Reinvestment Act of 2009 (ARRA) increased the credit amount from 40% to 45% of a family's first $12,570 of earned income for families with three or more children and the beginning point of the phase-out range for married coupled filing a joint return by $1,880. The enhancements were set to expire for the 2011 taxable year. The 2010 Tax Relief Act extended the enhancements through the 2011 and 2012 taxable years. ATRA extends for five additional years, through 2017, the expansions that increased the EITC for families with three or more children and increased the phase-out range for all married couples filing a joint return.

North Carolina Background. – North Carolina provides a State income tax credit to a taxpayer who is eligible for the federal EITC. The amount of the credit is equal to 5% of the amount of credit allowed under the Code. The credit is set to expire January 1, 2014. North Carolina conformed to the EGTRRA enhancements to the federal credit in 2001 and to the extension of those enhancements under the 2010 Tax Relief Act.

Adoption Credit

Section 10 of the act conforms to changes made under ATRA to the adoption credit, but it adjusts the North Carolina credit amount from 50% to 30% for the 2013 tax year to achieve revenue neutrality.

Explained. – Taxpayers who adopt children can receive a tax credit for adoption expenses. Qualified adoption expenses include adoption fees, court costs, attorney fees, and other expenses related directly to the legal adoption of an eligible child. A taxpayer may also exclude from income adoption expenses paid by an employer.

Federal Background. –EGTRRA increased the credit from $5,000[74] to $10,000, and provided a $10,000 income exclusion for employer-assistance programs. The Patient Protection and Affordable Care Act of 2010 extended these benefits to 2011 and made the credit refundable. The 2010 Tax Relief Act extended the enhancements made by EGTRRA for one year. ATRA made permanent the increased adoption credit amount and the exclusion for employer-assistance programs as enacted in EGTRRA. Therefore,

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[73] The deduction is subject to a phaseout. For every $1,000, or fraction thereof, by which the taxpayer's AGI exceeds $100,000, the amount of mortgage insurance premiums treated as interest is reduced by 10%.

[74] $6,000 for a special needs child.

the adoption credit and income exclusion maximum amounts are $10,000, adjusted for inflation, with an income phase-out range between $150,000 and $190,000, adjusted for inflation

North Carolina Background. – North Carolina provides a State income tax credit to a taxpayer who is eligible for the federal adoption credit. The amount of the credit is equal to 50% of the amount of credit allowed under the Code. The credit is set to expire January 1, 2014. North Carolina conformed to the EGTRRA enhancements to the federal credit in 2001 and to the extension of those enhancements under the 2010 Tax Relief Act.

IRC Update

Federal Provision	Decouple/Conform		Cost to Conform		2 FY Total
	For tax year 2012	For tax year 2013	FY12-13	FY13-14	
BUSINESS-RELATED PROVISIONS					
Bonus Depreciation	(No 2012 law change)	Decouple			
Enhanced Section 179 Expensing	Decouple	Decouple			
15-year depreciation schedule for leasehold, restaurant, and retail property	Conform	Conform	-2	-3	
Work Opportunity Tax Credit	Conform	Conform & Adjust	-1		
INDIVIDUAL-RELATED PROVISIONS					
Limitation on Itemized Deductions	(No 2012 law change)	Conform	-1	-3	
Education-Related Expenses					
• Qualified Tuition & Expenses Deduction	Conform	Decouple	-3		
• Student Loan Interest Deduction	Conform	Conform	-3	-6	
• Income Exclusion for Employer-Provided Education Assistance	Conform	Conform	-3	-6	
Residence-related Benefits					
• Mortgage Insurance premium as interest	Conform	Decouple	-5		
• Income exclusion for discharge of residence indebtedness	(No 2012 law change)	Decouple	-2		
Tax-free distribution from IRAs to charity/age 70.5 or older	Conform	Decouple	-4		
Earned Income Tax Credit	(No 2012 law change)	Conform & Adjust			
Adoption Tax Credit	(No 2012 law change)	Conform & Adjust			
			-24	-18	-42

PROPERTY TAX/DEANNEXATION.

Session Law	*Bill #*	*Sponsor*
S.L. 2013-19	**SB 97**	**Senator Goolsby**

AN ACT TO REQUIRE RELEASE OF PROPERTY TAXES IN ANY AREA THAT WAS PART OF A MUNICIPALITY FOR SIX MONTHS OR LESS AND THEN DEANNEXED.

SUMMARY: S.L. 2013-19 authorizes the governing body of a municipality to release property tax if the property was within the corporate limits for less than six months and if the municipality has not sent notice of the property tax. S.L. 2013-19 is effective when it becomes law and expires July 1, 2016.

CURRENT LAW: Property taxes are levied on a fiscal year basis with each fiscal year beginning on July 1 and ending the following June 30. Property added through annexation is subject to prorated property taxes as provided in G.S. 160A-58.10.

G.S. 105-380 prohibits the governing body of any taxing unit from releasing, refunding, or compromising any property taxes within its jurisdiction.

BILL ANALYSIS: S.L. 2013-19 authorizes the governing body of a municipality to release property tax if the property was within the corporate limits for less than six months and if the municipality has not sent notice of the tax.

BACKGROUND: In May 2009, the City of Wilmington voted to annex an area commonly known as "Monkey Junction." Originally scheduled to be annexed in June 2010, the effective date of the annexation was delayed due to litigation and did not become effective until January 1, 2012. S.L. 2012-3, effective July 1, 2012, deannexed the Monkey Junction area.

Under current law, the area annexed on January 1, 2012, and deannexed July 1, 2012, would be subject to prorated property tax for the tax year that began on July 1, 2011.

The City of Wilmington indicated that notice of the tax for Monkey Junction has not been sent, and no taxes have been collected from the area.

EFFECTIVE DATE: S.L. 2013-19 is effective when it becomes law and expires July 1, 2016.

ECONOMIC DEVELOPMENT JOBSITES PROGRAM.

Session Law	*Bill #*	*Sponsor*
S.L. 2013-130	**HB 439**	**Rep. Howard, Moffitt, Murry, Tine**

AN ACT TO CREATE AN INFRASTRUCTURE PROPERTY TAX DEFERRAL PROGRAM.

SUMMARY: Session Law 2013-130 creates a property tax deferral program to defer a portion of taxes on a parcel of property if the parcel (i) is at least 100 contiguous acres, (ii) is zoned for industrial and/or office use, (iii) does not have a building permit for a primary building or structure issued for it, and (iv) is classified under the present use value (PUV) property tax deferral program or was classified under the PUV program within the previous six months. The portion of taxes to be deferred is the sum of the value of any improvements on the site and the difference between the true value of the site and the value of the site treated as agricultural land in the present-use value program.

PRIOR LAW: North Carolina previously had seven property tax deferral programs: (i) historic district property held as a future site of historic structures, (ii) the circuit breaker tax deferral program, (iii) nonprofit property held as a future site of low or moderate income housing, (iv) PUV property, (v) working waterfront property, (vi) historic property, and (vii) the inventory deferral program. Uniform tax provisions for all deferral programs include the following:

- Taxes that are deferred under one of these programs become a lien on the property, which is extinguished when the taxes are paid.
- The deferred taxes are due and payable on the day the property loses its eligibility for deferral as a result of a disqualifying event.
- Interest accrues during the deferral period as of the date the taxes would have originally become due without the deferral program.
- Upon disqualification, the tax for a year in which a disqualifying event occurs is computed without the benefit of the deferral program.

BILL ANALYSIS: This act creates an eighth property tax deferral program for sites with potential to be developed for office or industrial applications in order to encourage horizontal improvement so as to make the sites more readily adapted to those uses in a shorter timeframe. In order to qualify, the site must be zoned for office and/or industrial use, must consist of at least 100 acres, may not have a building permit for a primary building or structure issued for it, and must be currently enrolled in or have been enrolled within the previous six months in the PUV program. The amount of property tax liability that can be deferred is the portion of tax that represents the increase in the property value resulting from any existing horizontal improvement plus the difference between the property valued at its true value and the property valued as agricultural land in the present use value system.

The deferred taxes are carried forward in the records of the county and, if applicable, the city in which the property is located until the occurrence of a disqualifying event. A disqualifying event causes the current years' tax liability (without benefit of the program) and some previous years' deferred tax liability to be due and payable as follows:

- If, within five years of classification, an amount equal to the deferred taxes is not invested in improvements to make the land suitable for office and/or industrial use ("minimum investment"), the deferred taxes for the preceding five years are due and payable.
- If the minimum investment is made but the property is classified for 10 years in the program, the deferred taxes for the preceding five years are due and payable.
- If some or all of the land is rezoned for a use other than office and/or industrial use, all deferred taxes are due and payable.
- If land is transferred or a building permit issues for the land, the deferred taxes (for only that portion transferred or to which the permit applies) for the preceding year are due and payable. The remaining parcel continues to receive treatment under this classification, even if it no longer meets the size requirement.

The tax collector must annually notify the owner of the accumulated sum of deferred taxes and interest. The owner must notify the county assessor if the land loses eligibility for the program, or the owner will be subject to a penalty of 10% of the total amount of deferred taxes and interest. The uniform provisions for deferral programs apply to this tax deferral program. Annual applications should be filed within the regular listing period and may be filed later if the board of equalization and review determines there is good cause for the lack of timely filing.

Deferred taxes are not triggered if land enrolled in the program is eligible and is transitioned back into a PUV program. The Secretary must annually report the number and

location of lands enrolled in the program to the Department of Commerce, and the Department of Commerce must include that information in an annual publication.

EFFECTIVE DATE: This act became effective for taxes imposed for taxable years beginning on or after July 1, 2013.

AMEND DEFINITION OF SPECIAL PURPOSE PROJECT.

Session Law	*Bill #*	*Sponsor*
S.L. 2013-135	**HB 629**	**Rep. Martin, R. Brawley, Lewis**

AN ACT TO AMEND THE DEFINITION OF A SPECIAL PURPOSE PROJECT TO INCLUDE AGRICULTURAL AND FORESTRY WASTE DISPOSAL FACILITIES.

SUMMARY: S.L. 2013-135 amends the definition of a special purpose project to include agricultural and forestry waste disposal facilities.

CURRENT LAW: A "special purpose project" is defined as any structure, equipment, or other facility for any one or more of the following purposes: water systems or facilities; sewage disposal systems; public transportation systems; public parking lots; public auditoriums; recreational facilities, including museums; rehabilitation facilities; orphanages; or land, equipment, and facilities for the disposal, treatment, or recycling of certain solid waste, etc.

The Local Government Commission may approve the issuance of bonds for special purpose projects under the Industrial and Pollution Control Facilities Financing Act. The governing body of the county in which the special purpose project is located must notice and conduct a public hearing and approve in principle the issuance of bonds beforehand.

The Industrial and Pollution Control Facilities Financing Act authorizes the issuance of tax-exempt industrial development and pollution control bonds. Under this Act, a local political subdivision issues bonds, the proceeds of which are used to finance the acquisition and construction of industrial, pollution control, or other capital facilities to be used by a private company. The bonds are secured by and are sold exclusively on the basis of the company's obligation to make payments under a financing agreement entered into between the company and the political subdivision. Because the interest on the bonds is exempt from North Carolina and federal income taxes, the interest payments (made indirectly by the private company) are considerably lower than would be required in an ordinary taxable financing. The type and size of facilities that may be financed by industrial development and pollution control bonds are limited by both federal and state law.

BILL ANALYSIS: This act amends the definition of "special purpose project" to include land, equipment, and facilities for the disposal, treatment or recycling of solid waste, forestry waste, agricultural waste, or other waste including any residual material which is the byproduct or excess raw material remaining after the completion of any commercial, consumer, governmental, agricultural, or industrial production process. Included within this purpose are facilities for the handling and transport of products resulting from treatment and recycling.

BACKGROUND: Currently there are two waste wood facilities planned for North Carolina that will export wood pellets to a major English power plant. The first plant will be located in Wilson County with construction to begin this summer. The second plant is slated to be built near Gulf in Chatham County.

EFFECTIVE DATE: This act became effective June 19, 2013.

TAXPAYER DEBT INFORMATION ACT.

Session Law	*Bill #*	*Sponsor*
S.L. 2013-200	**HB 248**	**Rep. Conrad, Fulghum, Cleveland, Blust**

AN ACT TO REQUIRE DISCLOSURE ON THE BALLOT THAT AUTHORIZATION OF INDEBTEDNESS INCLUDES INTEREST AND THAT TAXES MAY BE LEVIED TO REPAY THE INDEBTEDNESS.

SUMMARY: S.L. 2013-200 makes the estimation of interest on a proposed bond issuance of voted debt by a local government part of the LGC review process and requires the ballot question for the authorization of bonds to state that the authorization includes interest and that additional taxes may be levied to repay the debt.

The act became effective September 1, 2013.

CURRENT LAW: Article 4 of Chapter 159 of the General Statutes (Local Government Bond Act) governs the ability of units of local government to borrow money secured by a pledge of the taxing power. When a local government proposes to issue bonds that must be approved by a vote of the people,[75] it must publish a notice of intent to apply to the Local Government Commission (LGC) for approval. After considering an application, the LGC enters an order either approving or denying the application after considering several factors. The LGC must approve the application if it determines the following:

- **The proposed bond issue is necessary or expedient.**
- **The proposed amount is adequate for the proposed purpose.**
- **The unit's debt management procedures are good, or that reasonable assurances have been given that its debt will be managed in strict compliance with the law.**
- **The increase in taxes, if necessary to service the proposed debt will not be excessive.**
- **The proposed bonds can be marketed at reasonable rates of interest.**

Upon approval, the local government must hold a public hearing, followed by a bond referendum. Bonds may be issued under a bond order at any time within seven years after the order takes effect and up to 10 years with LGC approval. Any action contesting the validity of a bond referendum must begin within 30 days after the publication of the results. After this time period, no right of action may be brought. Chapter 142 governs the issuance of State debt.

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[75] Bonds issued for the following purposes do not require voter approval: (1) to suppress riots, insurrections, or any extraordinary breach of law and order; (2) to supply an unforeseen deficiency in the revenue when taxes actually received or collected during the fiscal year fall below collection estimates made in the annual budget ordinance; (3) to meet emergencies threatening the public health or safety, as conclusively determined in writing by the Governor; (4) to refund outstanding general obligation bonds or general obligation bond anticipation notes; (5) bonds as described in G.S. 159-49(2). There are also certain other purposes for which no vote is required to the extent of two-thirds of the amount by which the outstanding indebtedness of the issuing county, county water and sewer district, metro water district, or city was reduced in the preceding fiscal year.

BILL ANALYSIS:

***Statement of Estimated Interest.* – After or at the same time the application is filed, a bond order must be introduced before the governing board of the local government. Once introduced, the board must schedule a public hearing.**

Section 1 of the act requires that, after the bond order has been introduced but before the public hearing, the finance officer of the local government unit file a statement with the clerk and the LGC indicating the estimated total amount of interest that will be paid on the bonds over the expected term of the bonds and a summary of the assumptions upon which the estimate is based. It must also include a statement to the effect that the estimate is preliminary, that there is no assurance that the assumptions upon which the estimate is based will occur, and that the actual circumstances at the time the bonds are issued from the assumptions could result in significant differences between the estimated interest and the actual interest. Section 1 also provides that the validity of the bonds is not subject to challenge on the grounds that the actual interest when issued is different than the amount set forth in the statement.

Publication of Bond Order. – The bond order must be published after it has been introduced and again after it has been approved. Upon publication after introduction, it must include a statement describing the amount of the proposed bonds, indicating that a tax may be levied to pay the principal and interest on the bonds, and announcing when the public hearing will be held. Upon publication after adoption, it must include a statement that any action challenging the validity of the order must commence within 30 days after the date of publication of the notice.

Sections 2 and 3 of the act add similar language to each of the statutes related to the publication of the bond order. They would require inclusion of a statement in the order that the finance officer has filed a statement of estimated interest and indicating what the estimated amount is. The changes would permit a summary of the assumptions to be included in the publication and would include disclaimer language to the effect that the estimated amount of interest is preliminary, is for general informational purposes only, and that the validity of the bonds may not be challenged on the basis of the actual interest being different than the estimated interest once the bonds are issued.

***Ballot Question.* – Under current law, the form of the question on the ballot for a local bond order is as follows:**

"Shall the order authorizing $ _____ bonds for (briefly stating the purpose) be approved?

[ ] YES

[ ] NO"

Section 4 of the act requires that the ballot question also indicate that the approval includes the application of interest to the principal debt amount authorized, but would not state a specific amount of estimated interest. The ballot would also include a statement that additional taxes may be levied in an amount necessary to pay the principal and interest on the bonds.

EFFECTIVE DATE: This act became effective September 1, 2013, and applies to bonds proposed on or after that date.

EXCLUDE CUSTOM SOFTWARE FROM PROPERTY TAX.

Session Law	*Bill #*	*Sponsor*
S.L. 2013-259	**SB 490**	**Sen. Gunn, Barefoot, Walters**

AN ACT TO EXCLUDE CUSTOM SOFTWARE FROM PROPERTY TAX.

SUMMARY: S.L. 2013-259 excludes custom computer software from local property tax. Embedded software and the prewritten portion of capitalized, third-party software remain subject to local property tax.

CURRENT LAW: The only forms of intangible personal property subject to local property tax are leasehold interests in exempt real property (G.S. 105-275(31)) and certain computer software (G.S. 105-275(40)).

Under G.S. 105-275(40), computer software and documentation related to the software is excluded from local property tax except the exclusion does not apply to:

- **Embedded software or microcode –** Computer instructions that reside permanently in the internal memory of a computer system and are not intended to be removed without terminating the operation of the computer system and removing a physical part.
- **Capitalized, third-party software** – Computer software that is purchased or licensed from a unrelated person and that is capitalized by the taxpayer under generally accepted accounting principles (GAAP). A person is unrelated to a taxpayer if (1) the taxpayer and the person are not subject to any direct or indirect common ownership and (2) the taxpayer and the person do not have any direct or indirect ownership interest in the other.

BILL ANALYSIS: S.L. 2013-259 narrows the definition of computer software subject to local property tax. The capitalized, third-party software currently subject to local property tax would be limited to software that was not customized through development or modification to meet the customer's specified needs. S.L. 2013-259 excludes customized software from local property tax regardless of who customized the software (i.e., internally by the taxpayer or externally by a third party).

S.L. 2013-259 leaves embedded software subject to local property tax. S.L. 2013-259 only subjects the prewritten portion of capitalized, third-party software to local property tax. S.L. 2013-259 also prohibits State courts from using the law change to interpret any statute in pending litigation.

BACKGROUND: On July 21, 2011, the NC Department of Revenue issued a memorandum to county tax assessors explaining the taxability of modifications to computer software. The Department of Revenue concluded that modifications to taxable software are taxable and modifications to excluded software are excluded. The Department of Revenue's position is based on the interpretation that software, including any modifications, is either taxable or excluded and that property is not subdivided into parts to determine taxability.

The Department of Revenue's memorandum addresses only modifications to software. S.L. 2013-259 addresses both modifications to software and the taxability of customized software that would be taxed as capitalized, third-party software.

EFFECTIVE DATE: S.L. 2013-259 is effective for taxes imposed for taxable years beginning on or after July 1, 2014.

TAX SIMPLIFICATION AND REDUCTION ACT.

Session Law	*Bill #*	*Sponsor*
S.L. 2013-316	**HB 998**	**Rep. Lewis, Setzer, Moffitt, Szoka**

AN ACT TO SIMPLIFY THE NORTH CAROLINA TAX STRUCTURE AND TO REDUCE INDIVIDUAL AND BUSINESS TAX RATES.

SUMMARY: S.L. 2013-316 repeals the estate tax and reduces individual and business tax rates. To help offset the revenue loss from rate reductions applicable to all taxpayers, the act eliminates some tax expenditures and expands the sales tax base. The act makes the following changes to the State's tax structure:

- ***Eliminates the estate tax for decedents dying on or after January 1, 2013.***
- ***Replaces the individual marginal tax brackets with a flat rate. The rate is 5.8% for taxable year 2014 and 5.75% for taxable years thereafter. The act retains the 100% deduction for social security income, enhances the current child credit, increases the standard deduction, and retains the deduction for charitable giving. It eliminates the personal exemption, caps the mortgage interest expense deduction, and repeals many other deductions and credits.***
- ***Reduces the corporate income tax rate to 6% for taxable year 2014, 5% for taxable year 2015, and possibly 3% or 4% in the years thereafter if General Fund revenues equal or exceed an established trigger amount of $20.2 billion in fiscal year 2014-15 or $20.975 billion in fiscal year 2015-16.***
- ***Eliminates several sales tax exemptions and preferential tax rates, effective January 1, 2014, and July 1, 2014.***
- ***Replaces the franchise tax on electricity and the excise tax on piped natural gas with a sales and use tax at the State combined general rate on the gross receipts derived from sales of electricity and piped natural gas, effective July 1, 2014.[76]***
- ***Replaces the gross receipts privilege tax on amusements and taxes amusements with a sales tax on admission charges to an entertainment event at the applicable State and local sales tax rate, effective January 1, 2014.***
- ***Expands the sales tax to include the sales price of service contracts, effective January 1, 2014.***
- ***Establishes an annual gross income tax requirement of $10,000[77] from farming operations to qualify for the sales tax exemptions for farmers, effective July 1, 2014.***
- ***Caps the annual sales tax refund amount a single nonprofit may receive at a State and local combined amount of $45 million, effective July 1, 2014.***
- ***Extends the sunset date applicable to sales tax refunds for passenger air carriers and motorsports for two years, from January 1, 2014, to January 1, 2016.***

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[76]See S.L. 2014-39; it phases-in the sales tax on sales of piped natural gas by the eight gas cities and on sales of electricity by the Cape Hatteras EMC over two years.

[77] See S.L. 2014-3; it allows a three-year income averaging of income and provides a conditional exemption certificate for new farmers.

- ***Caps the motor fuel excise tax at 37.5 cents per gallon for the period September 1, 2013, through July 1, 2014.***
- ***Directs the Revenue Laws Study Committee to study various tax policy issues.***

CURRENT LAW AND BILL ANALYSIS: S.L. 2013-316 reduces individual and corporate income tax rates, eliminates many tax expenditures, equalizes the tax treatment of utility services, and expands the sales tax base to include amusements and service contracts. The changes reduce revenues by $86.6 million in fiscal year 2013-14 and reduce the growth of revenues by 27% over five years. The projected revenue in fiscal year 2017-18 without these changes is $24,267.2 billion; the projected revenue in fiscal year 2017-18 with the changes made by this act is $23,617.3 billion.

PART I. INDIVIDUAL INCOME TAX CHANGES

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 tax brackets with rates of 6%, 7%, and 7.75%. Under the act, there is a flat 5.8% tax rate on taxable income for taxable year 2014 and a 5.75% tax rate for taxable years thereafter.[78] It broadens the base by eliminating most of the credits and deductions allowed under current law. It does not change the taxability of social security income. It increases the standard deduction amounts and eliminates the personal exemptions. It enhances the child credit, retains the itemized deduction for charitable giving, and caps the itemized deduction for mortgage expense and property taxes paid on real estate.

Bill Section	Brief Description
Section 1.1(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), credit for children, and income tax returns.
Section 1.1(b)	• 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. The repeal is effective for taxable years beginning on or after January 1, 2014. • Repeals statutes whose contents are incorporated into other newly created statutes: 105-134.2, income tax imposed and 105-134.3, year of assessment. • Replaces 105-134.6, adjustments to AGI, with 105-153.5. Many of the adjustments allowed under 105-134.6 are not continued under 105-153.5 and are thus repealed, effective for taxable years beginning on or after January 1, 2014: ○ Deduction for various itemized deductions allowed under federal law such as the medical expense deduction.

[78] The highest marginal tax rates in the surrounding states are as follows: GA, 6%; SC, 7%; TN, 0%; VA, 5.75%.

	○ Additional standard deduction amount allowed for the aged or blind. ○ Deduction of up to $4,000 allowed for income received from one or more state, local, or federal government retirement plans. ○ Deduction of up to $2,500 allowed for income received from a retirement plan other than a governmental retirement plan. ○ Deduction of up to $35,000 allowed for severance wages.[79] ○ Deduction for the amount paid to a taxpayer as compensation for pecuniary loss suffered by reason of erroneous conviction and imprisonment. ○ Deduction for payments received from Disaster Relief Fund.[80] ○ Deduction equal to 5% of the gross purchase price of a qualified sale of a manufactured home community.[81] ○ Deduction not to exceed $50,000 of net business income.[82] ○ Adjustment for federal estate tax that is attributable to an item of income in respect of a decedent.[83] ○ Deductions for amounts contributed to a NC 529 college savings plan.[84] ○ Deduction of $250 for an unpaid member of a volunteer fire department or volunteer recue or emergency medical services squad. ○ Deductions for interest and investment income earned on a trust under the Tobacco Settlement Agreement.[85] This deduction is obsolete. ○ Deduction for payments received from Hurricane Floyd Reserve Fund. This fund no longer exists. This deduction is obsolete.

[79] Unemployment benefits are subject to income tax, and will continue to be subject to income tax.
[80] Under the Code, most payments received for disaster relief would be deductible as an itemized deduction; payments for lost income are not deductible under the Code. State law provided that in addition to the itemized deductions allowed, a deduction would be allowed for payments for lost income. Under the act, none of the payments would be deductible.
[81] S.L. 2008-107. The deduction was scheduled to sunset for taxable years beginning on or after January 1, 2015.
[82] S.L. 2011-145.
[83] Removing the adjustment simplifies the tax code. Its purpose is to avoid double taxation by both the decedent's estate and the beneficiary. Its scope is small.
[84] The interest earned on the plan continues to be exempt for federal and state tax purposes. The deduction only applied to amounts contributed to a NC 529 college savings plan, not to amounts contributed to any other college savings plan.
[85] Entity for which this deduction enacted chose to organize as a C-corporation. Therefore the deduction in the individual income tax law is not used or needed. The provision was part of an agreement for the Fund to reside in NC, *see S.L. 1999-333*.

	○ Addition for amounts allowed as a deduction under the Code by a separate tax. This deduction is obsolete. [86] • Repeals the following tax credits that do not have a sunset and that are only applicable to individual income tax: 105-151.11, child care credit; 105-151.18, credit for the disabled; 105-151.21, credit for taxes paid on farm machinery; 105-151.26, credit for charitable contributions made by non-itemizers, and 105-151.33, credit for education expenses.[87] The repeal is effective for taxable years beginning on or after January 1, 2014. • Repeals the following tax credits that do not have a sunset and are applicable to both individual and corporate income tax: 105-151.1, credit for construction of dwelling units for handicapped persons; 105-151.12, credit for real property donations; 105-151.13, credit for conservation tillage equipment; 105-151.14, credit for gleaned crops; and 105-151.25, credit for construction of poultry composting facility. The repeal is effective for taxable years beginning on or after January 1, 2014. • Allows the following tax credits that are only applicable to individual income tax to sunset as scheduled: 105-151.28, credit for premiums paid on long-term care insurance; 105-151.31, earned income tax credit; and 105-151.32, credit for adoption expenses. • Allows the following tax credits that are applicable to both individual and corporate income tax to sunset as scheduled; the credits sunset for the 2014 taxable year unless otherwise noted: NC ports, film production (2016), recycling oyster shells, investing in renewable energy (2016), donating money to a nonprofit or governmental entity to invest in renewable energy (2016), constructing renewal fuel facilities, biodiesel producers, work opportunity, renewable energy property facility, historic rehabilitation (2015), low-income housing (2015), interactive digital media, mill rehabilitation (2015), Article 3J, and railroad intermodal facilities (2038).
Section 1.1(c)	Repeals the definition for retirement benefits. The definition is not needed because the deduction for retirement benefits is eliminated.
Section 1.1(d)	Replaces the graduated marginal tax rates of 6%, 7%, and 7.5% with a flat rate of 5.8% for taxable year 2014 is 5.8%. *New G.S. 105-153.7.*

[86] This provision was enacted for lump sum distributions when those distributions were deductible for federal income tax purposes. Today, those amounts are included in federal taxable income. For federal tax purposes, the income may be taxed at different rates.

[87] S.L. 2013-364, House Bill 269, also repealed the tax credit for educational expenses for children with disabilities and provided a scholarship grant for essentially the same group of people. A grant may not exceed $3,000 per semester.

	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. *New G.S. 105-153.5.*
	• To determine NC taxable income, the only adjustments a person would make to adjusted gross income, as determined under the Internal Revenue Code, are as follows:
	  ○ Deduction of any Social security benefits received and included in federal taxable income.
	  ○ Deduction of those amounts that cannot be included in the tax base by federal law, amounts received under the Railroad Retirement Act, interest on US obligations, and income from an Indian tribe.
	  ○ Deduction for those amounts that cannot be included in the tax base by a North Carolina court order, namely pension income received to the extent the amount is exempt under the *Bailey* decision.[88]
	  ○ Deductions for those amounts generally accepted as a long-standing practice of the State – interest on State and local obligations, interest on nonprofit educational obligations, and gain from obligations issued prior to 1995 under bond law that exempted it.
	  ○ Adjustments designed to prevent double taxation, such as a deduction for refunds of income taxes included in gross income.
	  ○ Adjustments to conform to legislative decisions to decouple from federal income tax law, such as accelerated depreciation.
	• The standard deduction amount is increased from $6,000 to $15,000 for married taxpayers filing jointly; from $4,400 to $12,000 for heads of household; from $3,000 to $7,500 for single filers; and from $3,000 to $7,500 for married taxpayers filing separately.
	• There are only two federal itemized deductions allowed:
	  ○ Charitable contributions. – The same amount allowed as an itemized deduction under the Code.
	  ○ Mortgage interest and property taxes paid on real estate. – The same amounts allowed as an itemized deduction under the Code, capped at $20,000 for all taxpayers. Married taxpayers may not claim more than the cap amount, regardless of how the taxpayers choose to file.
	• The tax brackets eliminate the marriage penalty.
	• Consolidates and simplifies the adjustments when the State decouples from federal accelerated depreciation and expensing. *New G.S. 105-153.6.*[89]

Section 1.(e)	Increases the child credit from $100 to $125 per child if the taxpayer's AGI is below $40,000 for married filing jointly; $32,000 for head of

[88] Federal, State, and local governmental pension income is not taxable in North Carolina if the recipient of the pension income vested in the governmental retirement system on or before August 1989.

[89] See also House Bill 14, S.L. 2013-414, sections 34 and 58(a).

	household; and $20,000 for single/married filing separately. The act retains the current tax credit amount of $100 for a taxpayer's whose AGI is over $40,000 and up to $100,000, married filing jointly. The credit is not allowable to a taxpayer's whose AGI is over $100,000, married filing jointly.
Section 1.2	Reduces the individual flat income tax rate from 5.8% to 5.75% for taxable years beginning on or after January 1, 2015.
Section 1.3	Makes technical and conforming changes. Provides that the percentage amount to be withheld from lottery winnings is the individual income tax rate.

PART II. CORPORATE INCOME TAX CHANGES

This Part reduces the corporate income tax rate over a period of two years, with additional reductions possible in the third and fourth years. It simplifies the calculation and administration of the corporate income tax laws by eliminating most of the credits allowed under current law. It does not change the applicability, calculation, or rate of the franchise tax.

Bill Section	Brief Description
Section 2.1(a)	Reduces the corporate income tax rate from 6.9% to 6% for taxable year 2014.[90]
Section 2.1(b)	Repeals the following tax credits that do not have a sunset and are applicable to both individual and corporate income tax: 105-130.22, credit for construction of dwelling units for handicapped persons; 105-130.34, credit for real property donations; 105-130.36, credit for conservation tillage equipment; 105-130.37, credit for gleaned crops; and 105-130.44, credit for construction of poultry composting facility. The repeal is effective for taxable years beginning on or after January 1, 2014. Repeals the following tax credits that do not have a sunset and that are only applicable to corporate income tax: 105-130.39, credit for certain telephone subscriber line charges[91] and 105-130.43, credit for

[90] The corporate tax rate in the surrounding states is: FL, 5.5%, GA, 6%; SC, 5%; TN, 6.5%; VA, 6%.

[91] This statute allowed a tax credit for telephone companies that provide a discount to low income residents for home telephone service under the federal Lifeline program. The federal subsidy for local telephone service under the Lifeline program is $9.25 per month. The State is not required to provide a further subsidy for low income residents, but G.S. 62-140 allows the Commission to order a similar rate reduction. Under an Order of the State Utilities Commission, the State has required public utilities to give an additional reduction in rates of $3.50 for low-income residential consumers. The tax credit repealed by this act allowed the public utility to recover its cost of the reduction in rates. Section 11.1 of S.L. 2013-363 amended G.S. 62-140 to provide that if the State repealed the funding mechanism that allowed a public utility to recover its reduction in the local telephone rates for low-income residential consumers the Commission would be required to eliminate any subsidy funded by the tax credit. In 2011, there were 109,923 Lifeline subscribers. That number dropped to $67,065 in 2012; the reduction is probably due to a FCC requirement that companies recertify Lifeline subscribers. Many customers did not respond to the recertification request; this number may increase for 2013 as eligible subscribers who were de-enrolled choose to reapply for Lifeline service.

	savings and loan supervisory fees.[92] The repeal is effective for taxable years beginning on or after January 1, 2014. Allows the following tax credits that are applicable to both individual and corporate income tax to sunset as scheduled; the credits sunset for the 2014 taxable year unless otherwise noted: NC ports, film production (2016), recycling oyster shells, investing in renewable energy (2016), donating money to a nonprofit or governmental entity to invest in renewable energy (2016), constructing renewal fuel facilities, biodiesel producers, work opportunity, renewable energy property facility, historic rehabilitation (2015), low-income housing (2015), interactive digital media, mill rehabilitation (2015), Article 3J, and railroad intermodal facilities (2038). Allows the tax credit for manufacturing cigarettes for exportation to expire as scheduled (2018).
Section 2.2(a)	Reduces the corporate income tax rate from 6% to 5% for taxable years beginning on or after January 1, 2015.
Section 2.2(b)	Allows an additional 1% rate reduction for 2016 if the amount of net General Fund tax collected in fiscal year[93] 2014-15 exceeds $20.2 billion. Allows an additional 1% rate reduction for 2017 if the amount of net General Fund tax collected in fiscal year 2015-16 exceeds $20.975 billion. The rate reduction triggers reflect the anticipated General Fund tax collections for that fiscal year. The act provides that the corporate income tax rate for taxable year 2017 will be the rate for taxable years thereafter. The rate may be 5%, 4%, or 3%, depending upon whether one or more of the rate reduction triggers are met.
Section 2.3	Extends the sunset of the tax credit for research and development until taxable years beginning on or after January 1, 2016. Allows the tax credit for interactive digital media to sunset as scheduled for taxable years beginning on or after January 1, 2014.
Section 2.4	Repeals the corporate income tax earmarked for the Public School Building Capital Fund. This Fund has not received this earmarked amount since 2008 because it has been suspended each year in the appropriations act. The amount of the earmark is equal to 5/69 of the net corporate income tax collections, or roughly between $70 and $80 million annually.

PART III. SALES TAX CHANGES

This Part makes changes to the existing sales tax law. It increases the tax rate on some items that were either exempt or taxed at a lower rate. It also imposes some new thresholds and

[92] In 1985, the General Assembly allowed a tax credit for savings and loan associations equal to the amount of supervisory fees assessed on the association by the Commissioner of Banks. According to the 2011 Biennial Tax Expenditure report, this credit reduced General Fund revenues by approximately $300,000 annually.

[93] See S.L. 2014-100, Sec. 37.1; it clarifies what the term "net General Fund tax collected for a fiscal year" means for purposes of the corporate income tax rate trigger.

caps. It does not change the State or local sales tax rates. The State general rate is 4.75%; the combined general rate is 7%; and the local rates vary from 2% to 2.75%.[94]

Bill Section	Brief Description
	Modify Tax Rate on Manufactured and Modular Homes
Section 3.1(a)	Increases the sales tax rate on manufactured and modular homes to the State general rate, effective January 1, 2014.[95] Prior to the increase, the tax rate on manufactured homes was 2% with a $300 per article cap; the tax rate on modular homes was 2.5%.[96] The tax applies to the sales price, including the all accessories attached to the home when it is delivered to the purchaser, even if the charges for those accessories are separately stated on the invoice.
Section 3.1(b)	Repeals the distribution of 20% of the taxes collected on modular homes to counties.[97]
Section 3.1(c)	Provides that the local sales tax rate does not apply to sales of manufactured or modular homes. Generally, the local sales tax applies to any item subject to the State general rate. This section exempts manufactured homes and modular homes from the local sales tax base.[98]
Section 3.1(d)	Effective January 1, 2014, and applicable to sales made on or after that date. A sale occurs when title to the property transfers or possession is taken; not when the contract or agreement to purchase is signed.[99]
	Repeal Sales Tax Exemption for Nutritional Supplements
Section 3.2(a)	The exemption, G.S. 105-164.13(13c), applies to nutritional supplements sold by a chiropractic physician at a chiropractic office to a patient as part of the patient's plan of treatment. The General Assembly enacted this exemption in S.L. 1997-369, effective October 1, 1997. The term "nutritional supplement" is not defined. The federal Dietary Supplement Health and Education Act of 1994 defines a dietary supplement. There are no laws that require a dietary supplement to be sold only by health care providers. The dispensing of

[94] All counties have the authority to impose an additional .25% tax; as of April 1, 2013, 25 counties imposed the additional .25% local rate. Durham, Mecklenburg, and Orange counties have an additional .50% sales tax rate for public transit.

[95] See S.L. 2014-100, Sec. 37.3; it allows a sales tax exemption equal to 50% of the sales price, effective September 1, 2014.

[96] In committee discussions, some legislative members expressed a desire to begin taxing manufactured and modular homes more analogous to stick built homes. Sales tax does not apply to the sales price of a stick built home because it is real property and not tangible personal property; however, the State and local sales tax does apply to the cost of the materials used by the builder to create the home.

[97] S.L. 2003-400 began taxing modular homes at 2.5%, regardless of whether they were "on-frame" of "off-frame". Prior to 2003, on-frame modular homes were taxed as manufactured homes at 2%. Off-frame modular homes were not taxed to the ultimate consumer, but instead the general State and local sales tax rate applied to the cost of the materials used by the seller to create the home. The distribution to counties was made to help offset the local revenue loss to counties. The distribution is around $500,000 annually.

[98] The homes are subject to local property taxes annually.

[99]

	dietary supplements does not require a prescription. If sold elsewhere, a nutritional supplement would be subject to sales tax. Likewise, if a chiropractor sells other items of tangible personal property to their patients at their office, those items are subject to sales tax. This act repealed this exemption, effective January 1, 2014. All nutritional supplements will be subject to sales tax, regardless of where they are purchased or who sells them.
Repeal Sales Tax Exemption for Meal Plans	
Section 3.2(a)	The exemption, G.S. 105-164.13(27), applies to prepared food and food served to students in dining rooms regularly operated by State or private educational institutions or student organizations thereof. The exemption has existed since at least 1957. The provision of meals to students in higher educational facilities has changed extensively since 1957. Today, students purchase meal plans that may consist of both "meal swipes" and food dollars. In many instances, the schools contract with a third party to provide the meals. The current taxability of meals is a hodge-podge: meals purchased with cash are taxable; meals purchased by non-students are taxable; and items purchased with food dollars at locations not operated by the school's food service are taxable. Meals purchased with meal swipes are not taxable as well as meals purchased with food dollars at locations operated by the school's food service.[100] This act repealed the exemption, effective January 1, 2014.
Repeal Sales Tax Exemption for Newspapers	
Section 3.2(a)	The exemption, G.S. 105-164.13(28) applies to the sales of newspapers by newspaper street vendors, by newspaper carriers making door-to-door deliveries, and by means of vending machines. In 1957 all newspaper sells were exempt from tax. In 1961 the blanket exemption was repealed. The repeal that existed prior to this act meant similar products were taxed differently. Newspapers sold over the counter, digitally, and by subscription were taxable. Newspapers sold by independent newspaper carriers, subscriptions sold door-to-door, through vending machines, and by street vendors were exempt. Magazine sales had a similar dichotomy until 2009 when the General Assembly repealed the similar exemption provided for magazine sells. The repeal of the exemption was intended to equalize the tax treatment of newspapers. However, G.S. 105-164.13(50) exempts from sales tax fifty percent (50%) of the sales price of items sold through a coin-operated vending machine, other than tobacco.[101]
Conforming changes	
Section 3.2(b)	The sales tax exemption for food sold in an elementary or secondary school remains exempt from taxation. This subsection clarifies that the

[100] See S.L. 2014-3, Part IV; it addresses the sales tax issues related to the repeal of this exemption.

[101] See S.L. 2014-3, Part VIII; it provides that the 50% sales tax exemption for items sold through a vending machine does not apply to newspapers, effective October 1, 2014.

	exemption applies to all K-12 cafeterias, including public schools, private schools, charter schools, and regional schools.
Section 3.2(c)	Makes conforming changes to recognize that the effective date of a tax change applies the same to all items taxed at the general rate.
Section 3.2(d)	This section becomes effective January 1, 2014, and applies to sales made on or after that date.
Agricultural Sales Tax Exemption	
Section 3.3	Subsection (b) of this section repeals many of the sales tax exemptions for items purchased by farmers for farming operations under G.S. 105-164.13. Subsection (a) of this section creates a new statute that allows a sales tax exemption for the items previously exempted under G.S. 105-164.13 for *qualifying* farmers. To qualify for the exemption, a farmer must have an annual gross income of $10,000 or more from farming operations for the preceding calendar year. Under G.S. 105-164.13, anyone who purchased the listed items for farming received the exemption. The only items previously exempted under G.S. 105-164.13 that were not included in the new statute were obsolete items listed in G.S. 105-164.13(4d): metal flue used in curing tobacco. This section became effective July 1, 2014, and applies to items purchased on or after that date.[102]
Repeal Sales Tax Exemption for Bakery Thrift Stores	
Section 3.4(a)	This exemption, G.S. 105-164.(27a), applies to bread, rolls, and buns sold at a bakery thrift store. The General Assembly enacted the exemption in 2007 to ensure that all bread sold at a bakery thrift store is taxed at the same sales tax rate. A bakery thrift store is defined as a retail outlet of a bakery that sells at wholesale over 90% of the items it makes and sells at the retail outlet day-old bread, rolls, and buns returned to it by retailers that acquired those items from the bakery. If the bread sold at the thrift store is prepared at the thrift store bakery, it is taxed as prepared food and is subject to the State and local tax rate. If the bread sold at the thrift store is baked elsewhere, it is taxed as food and is subject to the local tax rate. This act repeals this exemption, effective July 2014, and applicable to sales made on or after that date.
Repeal Sales Tax Holidays	
Section 3.4(a)	Repeals the two sales tax holidays. In 2001, the General Assembly enacted a sales tax exemption applicable to clothing[103] school supplies[104] computers, printers, and software[105] and recreational equipment[106] The exemption applied to purchases made during the first weekend in August. The exemption was commonly referred to as

[102] See S.L. 2014-3, Part III; it made substantial and clarifying changes to the agricultural sales tax exemption, effective July 1, 2014. It allows a three-year income averaging and it provides a conditional exemption for new farmers.
[103] Applied to clothing with a sales price of $100 or less.
[104] Applied to items with a sales price of $100 or less.
[105] Applied to computers with a sales price of $3,500 or less and to computer supplies with a sales price of $250 or less.
[106] Applied to items with a sales price of $50 or less.

	the "back to school sales tax holiday." In 2008, the General Assembly enacted a similar sales tax exemption applicable during the first weekend in November for the following Energy Star-rated products: clothes washers, freezers and refrigerators, central air conditioners and room air conditioners, air-source heat pumps, ceiling fans, dehumidifiers, and programmable thermostats. This section repeals both of these sales tax holidays, effective July 1, 2014.
Nonprofit Refunds of Sales and Use Tax Paid	
Section 3.4(b) and (c)	Places a cap on the amount of State and local sales and use tax refund a nonprofit entity is allowed, effective for the fiscal year 2014-15. Nonprofit entities may apply for a semi-annual refund of the sales and use taxes paid on purchases on items used to carry on the work of the nonprofit entity. A request for a refund for the first six months of a calendar year is due the following October 15; a request for a refund for the second six months of a calendar year is due the following April 15. A refund application submitted more than three years after the due date is barred. Subsection (b) of this section provides that the aggregated annual refund amount of State sales and use taxes allowed an entity for a fiscal year may not exceed $31,700,000. Subsection (c) of this section provides that the aggregated annual refund amount of local sales and use taxes allowed an entity for a fiscal year may not exceed $13,300,000. This aggregate amount will have little impact on refunds currently received, but it may limit future refund amounts.
Section 3.4(c) and (d)	Makes conforming changes.
Extend Sunsets on Various Tax Refund Provisions	
Section 3.5	Extends the sunset for the following annual refund of sales and use taxes paid for two years, from January 1, 2014, to January 1, 2016: • On fuel in excess of $2,500,000 used by an interstate passenger air carrier. • On aviation fuel purchased by a professional motorsports racing team, a motorsports sanctioning body, or a related member of such a team or body that is used to travel to or from a motorsport event. • On 50% of the cost of any tangible personal property other than tires or accessories that comprises any part of a professional motorsport vehicle purchased by a professional motorsports racing team or a related member of a team.

PART IV. ELECTRICITY AND PIPED NATURAL GAS TAX CHANGES

This Part repeals the franchise tax on electricity and the excise tax on piped natural gas and replaces the taxes with a State sales tax on the sale of these utilities. A portion of both the franchise tax and the excise tax are shared with the cities on sales made within the cities. This Part repeals those tax-sharing provisions and substitutes a distribution of a portion of the sales tax derived from these utilities. The Part also directs the Utilities Commission to

adjust the rates set by utilities for electricity and piped natural gas to reflect the changes made by this Part.

Bill Section	Brief Description
Section 4.1(a)	Repeals the 3.22% franchise tax on electric power, water, and sewerage companies. It also repeals the following provisions that were related to the franchise tax: • The distribution of 3.09% of the franchise tax derived from sales within a city to that city. *G.S. 105-116.1* • The sales tax deduction for municipalities that sell electric power. *G.S. 105-164.21A* • The payments in lieu of franchise taxes paid by municipalities to the State and the distribution of those revenues. *G.S. 159B-27(b), (c), (d) , and (e)*
Section 4.1(c) and (e)	Subsection (c) repeals the preferential sales tax rates applicable to electricity: 2.83% for sales of electricity sold to a commercial laundry and 3% on other sales of electricity. Subsection (e) imposes a State sales tax on sales of electricity and piped natural gas at the combined general rate. The combined general rate is defined as the State's general rate plus the sum of the rates of the local sales and use taxes authorized for every county. That rate is currently 7%.
Section 4.1(d)	Repeals the excise tax imposed on sales of piped natural gas, Article 5E of Chapter 105, and the sales tax exemption for sales of piped natural gas.
Section 4.1(b) and (f)	Subsection (b) makes a conforming change. Subsection (f) provides that the changes made by this section become effective July 1, 2014.
Section 4.2	Directs the Utilities Commission to adjust the rates set by utilities for electricity and piped natural gas to reflect the changes made by Section 4.1 of this act.
Section 4.3	Provides for a distribution of part of the sales tax on electricity and piped natural gas to the cities. Previously, cities received a portion of the franchise tax imposed on electricity and a portion of the excise tax imposed on piped natural gas. This section creates a new distribution formula based upon the amount received by a city under those former distributions, plus growth.
Section 4.4	Makes conforming changes.
Section 4.5	Removes a sales tax preference for sales of electricity by the Cape Hatteras Electric Membership Corporation so that all sales of electricity are taxed the same.[107]

PART V. ADMISSION CHARGES TO AN ENTERTAINMENT ACTIVITY

This Part replaces the gross receipts privilege tax on live entertainment and motion pictures with a State and local sales tax on admission charges to an entertainment activity.[108] The

[107] See. S.L. 2014-39; it phases-in the sales tax on sales of piped natural gas by the eight gas cities and on sales of electricity by the Cape Hatteras EMC over two years.
[108] See 2014-3; it addresses several issues re: to the expansion of the sales tax base to admission charges for an entertainment activity.

two taxes differ in that the gross receipts tax was imposed upon the person engaged in providing the event; it was not designed to be passed directly onto the consumer. The sales tax is imposed upon the retailer, but it is intended to be passed onto the purchaser and borne by the purchaser instead of the retailer.[109] The gross receipts tax was payable monthly and the return covered the gross receipts received during the previous month.[110] The sales tax is due quarterly, monthly, or bi-monthly depending upon the tax liability of the retailer.[111]

Bill Section	Brief Description
Section 5.(a)	Repeals the 3% privilege tax imposed on live entertainment and the 1% privilege tax imposed on movies, effective January 1, 2014. This subsection also makes a conforming change by repealing the exemptions from the privilege tax. Some of these exemptions were retained by providing a similar sales tax exemption; others were not.
Section 5.(b)	Imposes a State and local sales tax on admission charges to an entertainment activity. The sales tax is a trust tax. It is payable by the purchaser to the retailer.[112] A retailer is considered to act as a trustee on behalf of the State when it collects tax from the purchaser. The tax should be stated and charged separately unless the retailer displays a statement indicating the sales price includes the tax. It defines an entertainment activity as the following: • A live performance or other live event. This base is substantially the same as the base for the 3% gross receipts privilege license tax under former G.S. 105-37.1. • A motion picture or film. This base is substantially the same as the base for the 1% gross receipts privilege license tax under former G.S. 105-38.1. • A museum, a cultural site, a garden, an exhibit, a show, or a similar attraction or a guided tour at any of these attractions. The imposition statute provides that an admission charge does not include a charge for amenities. In 2011, the General Assembly excluded amenities from the gross receipts privilege tax.[113] This act does not change the policy decision made in 2011.
Section 5.(c)	Exempts the following entertainment activities from the sales tax on admission charges: • An event held at an elementary or secondary school and is sponsored by the school. • A commercial agricultural fair. • A festival or activity that lasts no more than seven days and is sponsored by a nonprofit entity that is exempt from income tax and that uses the entire proceeds exclusively for the entity's nonprofit purpose.

[109] G.S. 105-164.7.
[110] By practice, some taxpayers remitted the gross receipts tax at the time the event occurred.
[111] G.S. 105-164.16.
[112] G.S. 105-164.7.
[113] S.L. 2011-330.

	• A youth athletic contest sponsored by a nonprofit entity.
Section 5.(d) and (e)	Repeals obsolete statutes and makes conforming changes.
Section 5.(f)	Makes these changes effective January 1, 2014. Provides that for admissions to a live event, the tax applies to the initial sale or resale of tickets occurring on or after that date so that tickets to an event are taxed under the same tax: either the gross receipts privilege tax or the sales tax.

PART VI. SERVICE CONTRACTS

This Part imposes a State and local sales tax on the sales price of a service contract.[114] This Part does not modify or repeal the sales tax exemption for installation charges when the charges are separately stated on the billing document given to the purchaser at the time of the sale.

Bill Section	Brief Explanation
Section 6.(a)	Defines a service contract as a warranty agreement, a maintenance agreement, a repair contract, or a similar agreement or contract by which the seller agrees to maintain or repair tangible personal property.
Section 6.(b)	Imposes a State and local sales tax on the sales price of a service contract.
Section 6.(c)	Exempts from sales tax a service contract provided for an item that is exempt from sales tax, other than a service contract for a motor vehicle. A motor vehicle is exempt from sales tax under G.S. 105-164.13(32) because it is subject to a highway use tax. The tax applies to service contracts for motor vehicles. Exempts from sales tax a service contract for a transmission, distribution, or other network asset contained on utility-owned land, right-of-way, or easement. Exempts from sales tax an item used to maintain or repair tangible personal property pursuant to a service contract if the purchase of the contract is not charged for the item.
Section 6.(d)	Makes these changes effective January 1, 2014.

PART VII. ELIMINATE ESTATE TAX

This Part repeals the estate tax and the generation-skipping transfer tax for decedents dying on or after January 1, 2013.[115]

In 2001, the federal estate tax was designed as a revenue sharing system where the federal estate tax gave estates a 100% credit for state estate tax. Because estates received a full credit for state estate tax imposed, the estates did not pay any additional estate tax if state estate tax also applied. In 2001, all fifty states and the District of

[114] See S.L. 2014-3; it addresses several issues re: to the expansion of the sales tax base to service contracts.

[115] North Carolina imposed an estate tax on the value of the estate over $5.25 million. The tax rate graduated from 0.8% to a maximum rate of 16% for taxable estates over $10,040,000.

Columbia imposed an estate tax. During 2012, the federal estate tax was scheduled to return to the 2001 law for decedents dying in 2013 – meaning that any state estate tax paid would be fully credited against federal estate tax.

On January 1, 2013, the US Congress passed the American Taxpayer Relief Act of 2012 (also called the "fiscal cliff bill"). The 2012 Act permanently changed the federal estate tax system starting January 1, 2013. It repealed the scheduled return to the 2001 version of the federal estate tax; it provides only a deduction for state estate tax paid. Because the deduction does not relieve estates of the financial loss of paying state estate tax, estates do pay additional estate tax if state estate tax applies.

PART VIII. CAP EXCISE TAX ON MOTOR FUEL

This Part caps the motor fuel excise tax rate for the period October 1, 2013, through July 1, 2015, at 37.5¢ per gallon. With a cap, the rate may fall below 37.5¢ per gallon for the given period but it may not exceed it. This provision effectively reduced the motor fuel excise tax rate on October 1, 2013, from 37.6¢ per gallon to 37.5¢. Effective July 1, 2014, the rate fell to 36.5¢ under the variable rate formula. The motor fuel tax rate has two components: a flat rate of 17.5¢ and a variable rate that may change every six months.[116] The variable rate is equal to 7% of the wholesale price of gasoline based on a weighted average price of gasoline and diesel, as reported by the US DOE Energy Information Administration.

A motor fuel excise tax is imposed on all motor fuel sold, distributed, or used in the State. The revenue generated by the motor fuel tax is distributed as set forth in G.S. 105-449.125. One-half cent of the excise tax on each gallon of gas is distributed to funds for underground tank storage cleanup water and air quality. The remaining excise tax revenue is allocated as follows:

- 75% to the Highway Fund and used for maintenance, transit, rail, State Highway Patrol, DMV, some secondary road improvement, Powell Bill distribution to local governments, and some other administrative needs. G.S. 105-449.126 credits 1/6 of 1% of this amount annually to the Wildlife Resources Fund to be used for the boating and water safety activities described in G.S. 75A-3(c).
- 25% to the Highway Trust Fund and used for construction of the intrastate system, some secondary road improvement, and Powell Bill distribution to local governments.

PART IX. STUDY AND EFFECTIVE DATE

[116]The variable rate component was introduced in 1986 as part of legislation that increased funding for road construction. In addition to the introduction of a 3% variable rate, which equated to 1.5¢ per gallon at that time, the legislation increased the flat rate from 12¢ per gallon to 14¢ per gallon. The General Assembly incorporated the variable rate in part as recognition that the cost of road construction increases as the cost of motor fuel increases because of the petroleum products used in road construction. In 1989, the General Assembly increased the flat tax rate to 17¢ per gallon and increased the variable component from 3% to 7% of the average wholesale price. In 1992, the tax rate was changed to the current rate of 17.5¢ per gallon plus 7% of the average wholesale price (S.L. 1991-538).

This Part provides a savings clause. It also gives the Secretary of Revenue the authority to compromise a taxpayer's liability for sales tax on an admission charge to an entertainment activity or on the sales price of a service contract if the taxpayer made a good faith effort to comply with the sales and use tax laws. This additional compromise authority expires July 1, 2020. The purpose of this additional authority is to recognize the compliance issues and learning curve associated with the expansion of the sales tax base to services.

NC CHARTER SCHOOL ADVISORY BOARD.

Session Law	*Bill #*	*Sponsor*
S.L. 2013-355	**20**	**Sen. Tillman, Soucek**

AN ACT TO CREATE THE NORTH CAROLINA CHARTER SCHOOLS ADVISORY BOARD AND MAKE OTHER CHANGES TO CHARTER SCHOOL LAWS.

SUMMARY: This act provides limited immunity for certain controlled substance offenses in cases of medical necessity, and also provides immunity to a practitioner who dispenses an agent to treat overdoses, or an individual who administers the agent to another person. This act becomes effective December 1, 2013, and applies to offenses committed on or after that date.

BILL ANALYSIS:

Section 1 of the act provides that a person seeking medical assistance for themselves for a "drug-related overdose" (defined term in the act), or a person who seeks medical assistance for another individual who is experiencing a drug-related overdose, has immunity from prosecution for any of the following offenses:

- Misdemeanor possession of a controlled substance.
- Felony possession of less than one gram of cocaine..
- Felony possession of less than one gram of heroin.
- Misdemeanor possession of drug paraphernalia.

Any evidence obtained in connection with an investigation of other crimes committed by a person who may be entitled to limited immunity under the act remains admissible as to those crimes.

Section 2 provides there is no civil or criminal liability for the following:

- A practitioner who prescribes, dispenses, or distributes naloxone hydrochloride, an opioid antagonist approved by the Food and Drug Administration for the treatment of a drug overdose, to (i) a person at risk of experiencing an opiate-related overdose, or (ii) to another person in a position to assist an at risk person.
- A person who received an opioid antagonist, and administers it to another person if they have a good faith belief the person is experiencing a drug-related overdose, and the person exercises reasonable care in administering the agent.

EFFECTIVE DATE: This act becomes effective December 1, 2013, and applies to offenses committed on or after that date.

NC CHARTER SCHOOL ADVISORY BOARD.

Session Law	Bill #	Sponsor
S.L. 2013-355	**SB 337**	**Sen. Tillman, Soucek**

AN ACT TO CREATE THE NORTH CAROLINA CHARTER SCHOOLS ADVISORY BOARD AND MAKE OTHER CHANGES TO CHARTER SCHOOL LAWS.
THIS SUMMARY COVERS ONLY SECTION 3 OF S.L. 2013-355. A SUMMARY OF THE ENTIRE LAW IS AVAILABLE AS S337-SMRQ-51(sl).

SUMMARY: Section 3 of S.L. 2013-355 exempts real property occupied by a charter school and exclusively used for educational purposes from local property tax. Ownership of the property is not required.

CURRENT LAW:

G.S. 105-278.4 exempts certain real and personal property used for educational purposes. Exemption has an ownership requirement.

G.S. 105-278.7 exempts certain real and personal property used for educational, scientific, literary, or charitable purposes. Exemption has an ownership requirement.

G.S. 105-275(43) provides an exemption from local property tax for real (and tangible personal property) that is subject to a capital lease under G.S. 115C-531. The definition of capital lease in G.S. 115C-531 requires a local board of education be a party to the capital lease for use as school buildings or school facilities.

BILL ANALYSIS: Section 3 of S.L. 2013-355 exempts real property occupied by a charter school and exclusively used for educational purposes from local property tax. The use test requires the charter school "wholly and exclusively" use the property. Ownership of the property is not required.

BACKGROUND: Charter schools often operate on property owned by a separate entity because the charter school is not authorized to enter into a mortgage to buy land. For example, a charter school may lease a building that is owned by an affiliated nonprofit entity. The affiliated entity would have the authority to buy land and mortgage the land to finance the purchase.

EFFECTIVE DATE: Section 3 of S.L. 2013-355 is effective for taxes imposed for taxable years beginning on or after July 1, 2013.

APPROPRIATIONS ACT OF 2013.

Session Law	Bill #	Sponsor
S.L. 2013-360	**SB 402**	**Sen. Brunstetter, Brown, Hunt**

AN ACT TO MAKE BASE BUDGET APPROPRIATIONS FOR CURRENT OPERATIONS OF STATE DEPARTMENTS, INSTITUTIONS, AND AGENCIES, AND FOR OTHER PURPOSES.
SUMMARY: This analysis summarizes only the finance-related provisions in S.L. 2013. The finance provisions of that act are as follows:

- ***Increases fees by $60 million, $54.2 million of which would impact the General Fund and $5.8 million of which would impact various special funds.***[117]

[117] The Senate budget increased fees remitted to the General Fund by $57.4 million and reduced fees remitted to various special funds by $38 million.

- ***Authorizes a sales tax refund for an interstate passenger air carrier for the period January 1, 2011 through June 30, 2011.***
- ***Restores for one year the transitional hold harmless payments to local governments for repealed reimbursements.***
- ***Increases funding for dredging by allocating to the new Shallow Draft Navigation Channel Dredging Fund 1/6 of 1% of the amount allocated to the Highway Fund from the motor fuel excise tax in addition to appropriating funds for that purpose.***
- ***Sets the insurance regulatory charge at 6%, increase the regulatory fee for the Utilities Commission to .13%, and set the electric membership corporation regulatory fee at $200,000.***
- ***Changes the distribution or use of existing tax proceeds as follows:***
    - ***Reallocates the distribution of the .74% gross premiums tax on property coverage contracts and dedicate 20% to the Workers' Compensation Fund for volunteer safety workers.***
    - ***Eliminates the tax return designation of $3 of a taxpayer's tax liability to be remitted to the NC Public Campaign Fund and repeals the Fund.***
    - ***Directs the portion of the special license plate fee and the deed stamp tax that is remitted to the Natural Heritage Trust Fund to the Clean Water Management Trust Fund and repeals the Natural Heritage Trust Fund.***

The act also makes the following changes related to economic development:

- ***Increases the JDIG application fee and reporting fee.***
- ***Repeals the statutorily-created regional economic development commissions.***
- ***Modifies the Industrial Development Fund and Utility Account.***

BILL ANALYSIS:

FEE INCREASES

S.L. 2013-360 increases fees by $60 million, $54.2 of which would impact the General Fund and $5.8 of which would impact various special funds.

FINANCE-RELATED CHANGES

Sales Tax Refund for Passenger Air Carrier. – An interstate passenger air carrier is allowed an annual refund of the sales and use tax paid by it on fuel in excess of $2,500,000. This refund will expire for purchases made on or after January 1, 2014. A request for a refund is due within six months after the end of the State's fiscal year. The refund period covers purchases made during the State's fiscal year. Refunds applied for after the due date are barred. The only taxpayer that currently qualifies for this credit is U.S. Airways.

In 2010, the sales tax refunds transitioned from a calendar year basis to a fiscal year basis. Because of the transition, U.S. Airways failed to timely file for a refund. In 2012, the General Assembly enacted legislation authorizing a sales tax refund for the period January 1, 2011, through June 30, 2011, and the refund was capped at $3,150,000. Without the cap, the taxpayer would have been entitled to a State sales tax refund of $6,340,000 for that same six-month period. In the availability statement of the House version of the 2012 budget, there was an adjustment in the amount of $6.3 million for the sales tax refund

application extension for U.S. Airways. In the Senate version, there was no adjustment to the availability statement for this purpose. In the budget as enacted there was a reserve in the amount of $3.15 million. Pursuant to the 2012 legislation, U.S. Airways applied for a refund for the full amount of $6.34 million.

Section 6.16 allows U.S. Airways to obtain a refund for the amount not previously refunded for the January-June 2011 period.

Temporarily Restore Hold Harmless Payment. – A decade ago, the General Assembly repealed the reimbursements it had traditionally provided to local governments as replacement for the revenue they lost due to the repeal of the property tax on inventories and on poultry and livestock, the repeal of the intangibles tax, the "homestead exclusion" from property tax, and the repeal of local sales and use taxes on food purchased with food stamps. In place of the reimbursements, the General Assembly gave local governments the authority to increase their local sales tax by one-half percent and it provided a transitional hold harmless payment to those local governments whose potential gain from the half-cent local sales tax increase would be less than their loss from the repealed State reimbursements. The hold harmless distribution is made on or before August 15th of each year. The transitional hold harmless payments were to be made through August 2012.
Section 6.17 extends those payments for one additional year, through August 2013.
Set Regulatory Fees. – **Section 15.1** increases from .12% to 0.13% the rate for the public utility regulatory fee beginning with fiscal year 13-14. It also sets at $200,000 for fiscal years 13-14 and 14-15 the annual public utility regulatory fee imposed on electric membership corporations whose principal purpose is to furnish or cause to be furnished bulk electric supplies at wholesale. The proceeds of the fee are credited to the Utilities Commission and Public Staff Fund and used to reimburse the General Fund for appropriations made to the Utilities Commission to pay the expenses incurred in regulating public utilities.
The last time the rate of the public utility regulatory fee was changed was in fiscal year 04-05. The rate for this fee must be set each year by the General Assembly. The utility regulatory fee is a tax that was first imposed in 1989. The regulatory fee is imposed on all utilities that are subject to regulation by the North Carolina Utilities Commission. The fee is a percentage of the utility's North Carolina jurisdictional revenues. In general, jurisdictional revenue is derived from providing utility service in North Carolina.
The rate of the fee imposed on electric membership corporations has not changed since the General Assembly enacted it in 1999. The 1999 General Assembly enacted S.L. 1999-180, which authorized electric membership corporations to form subsidiary corporations that may provide energy services and products, telecommunications services and products, and water and wastewater collection and treatment. The subsidiary must fully compensate the electric membership corporation for its use of the corporation's personnel, services, equipment, and property. The Utilities Commission is charged with regulating this aspect of the subsidiary's business and, to pay for this regulation, S.L. 1999-180 levied a flat-rate regulatory fee to be paid annually by the North Carolina Electric Membership Corporation.[118] Thus, the fee imposed on the North Carolina Electric Membership Cooperation will be passed on to its member electric membership corporations.

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[118] The North Carolina Electric Membership Corporation is the only electric membership corporation whose principal purpose is to furnish or cause to be furnished bulk electric supplies at wholesale as provided in G.S. 117-16. It is a "generation and supply cooperative" owned by its members. Its members are all but one of the existing North Carolina electric membership corporations, which are "distribution cooperatives."

Section 20.3 sets the insurance regulatory charge at 6% for the 2013 and 2014 calendar years, the same as the rate set 2010, 2011, and 2012. The proceeds of the fee are credited to the Insurance Regulatory Fund and used to reimburse the General Fund for appropriations made to the Department of Insurance and other agencies to pay the expenses incurred in regulating the insurance industry. The insurance regulatory charge was first enacted in 1991 to defray the State's cost of regulating the insurance industry. The charge is a percentage of each insurance company's gross premiums tax liability.[119]
Section 34.29, as amended by S.L. 2013-363, Sec. 8.1, expands the retail value of a motor vehicle upon which the 3% highway use tax is imposed to include documentation fees and other administrative charges. This section becomes effective January 1, 2014.

CHANGES TO THE DISTRIBUTION OR USE OF TAX PROCEEDS

Clean Water Management Trust Fund. – **Section 14.3** directs the portion of the special license plate fee and the portion of the deed stamp tax[120] proceeds that are both currently remitted to the Natural Heritage Trust Fund to the Clean Water Management Trust Fund. The section also repeals the Natural Heritage Trust Fund.

***Scrap Tire, White Goods, and Solid Waste Disposal Taxes Credited to General Fund* - Section 14.16** directs 30% of the tax proceeds from the scrap tire disposal tax to the General Fund. This section ends the current earmarking of these proceeds to the Solid Waste Management Trust Fund, the Scrap Tire Disposal Account, the Inactive Hazardous Sites Cleanup Fund, and the Bernard Allen Memorial Emergency Drinking Water Fund. This section became effective July 1, 2013. **Section 14.17** directs 28% of the tax proceeds from the white goods disposal tax to the General Fund. This section ends the current earmarking of these proceeds to the Solid Waste Management Trust Fund and the White Goods Management Account. This section became effective August 1, 2013. **Section 14.18** directs 12.5% of the tax proceeds from the solid waste disposal tax to the General Fund. This section ends the current earmarking of these proceeds to the Solid Waste Management Trust Fund. This section became effective July 1, 2013.

***Increase Funding for Dredging.* – Section 14.22** allocates one-sixth of one percent of the amount that is allocated to the Highway Fund from the excise tax on motor fuel to the Shallow Draft Navigation Channel Dredging Fund created under the bill.
Workers' Compensation Fund for Volunteer Safety Workers.[121] – North Carolina imposes a 1.9% tax rate on the gross premiums of most insurance policies.[122] In addition to the general rate, there is an additional rate of .74% applied to the gross premiums on insurance policies for property coverage. Thirty percent (30%) of the net proceeds of this additional tax is credited to the Volunteer Fire Department Fund,[123] 25% of the net proceeds is credited to

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[119] Medical service corporations and health maintenance organizations began paying the charge in 2000.
[120] An excise tax is levied on each instrument by which any interest in real property is conveyed to another person. The tax rate is $1.00 on each $500 of the value of the interest conveyed.
[121] The House Finance Committee passed HB 27 on February 13, 2013, which proposed dedicating the 45% of the net proceeds that is currently credited to the General Fund to the Workers' Compensation Fund for the benefit of volunteer safety workers.
[122] Workers' compensation policies are taxed at 2.5%.
[123] Funds in the Volunteer Fire Department Fund provide matching grants to volunteer fire departments to purchase equipment and make capital improvements.

the Department of Insurance for disbursement to the county fire districts,[124] and the remainder (45%) is credited to the General Fund.

Section 20.2 reallocates the proceeds of the additional tax by dedicating 20% to the Workers' Compensation Fund for volunteer safety workers. Until April 1, 2016, if the amount remitted is insufficient to meet the needs of the Fund as determined by a DOI actuarial study, the shortfall may be made up either through increased premiums or through an assessment on local governments. Beginning on and after April 1, 2016, the shortfall may be made up only through an assessment on local governments.

NC Public Campaign Fund. – The North Carolina Public Campaign Fund was established in 2002 to offer public campaign financing to court candidates who agree to strict fundraising and spending limits and who reject special interest money and to produce a nonpartisan judicial voter guide, mailed to voters across the state in the weeks before Election Day. The Fund is funded through a $50 surcharge imposed on every active member of the North Carolina State Bar and the designation by a taxpayer on the income tax return of $3.00 of the taxpayer's tax liability.

Section 21.1 repeals the $50 surcharge, the $3.00 designation on the tax return, and the Fund. The State Board of Elections must use the existing money in the Fund only to publish judicial voter guides until the funds have been exhausted.

ADMINISTRATIVE CHANGES

Section 6.9 of S.L. 2013-360 authorizes the NC Department of Revenue to disclose a sample of tax information suitable for statistical analyses to the State Budget Director or the Director's designee. The sample does not include taxpayers' names and identification numbers. This section is effective July 1, 2013.

Section 7.17 of S.L. 2013-360 authorizes the NC Department of Revenue to enter into an additional public-private arrangement in order to expand the implementation of the Tax Information Management System (TIMS). TIMS is the replacement to the Department of Revenue's computer system for processing tax returns. The authority allows an additional $16,000,000 of projects related to TIMS that generate increased revenues or cost-savings greater than a revenue baseline. This section is effective July 1, 2013.

CHANGES RELATED TO ECONOMIC DEVELOPMENT

JDIG Changes. – **Section 15.19** requires Commerce to notify each governing body of an area where a submitted application proposes locating a project subject to any confidentiality agreements imposed by the Department. **Section 15.20** increases from $5,000 to $10,000 the application fee for a Job Development Investment Grant. Every business that is awarded a grant must submit an annual payroll report showing withholdings

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[124] The Insurance Commissioner will allocate to each county the amount of tax proceeds it received in the previous year. From that amount, the Commissioner will distribute to each fire district in the county the amount it received in the previous year. If the amount of proceeds to be allocated varies from the amount allocated the previous year, then the amount allocated to a county will be either reduced or increased by a percentage, the numerator of which is the population of the county and the denominator of which is the population of the State. If the amount to be distributed to the fire districts differs from the amount distributed the previous year, then the amount distributed will be either reduced or increased by a percentage, the numerator of which is the tax value of the property located in the district and the denominator of which is the tax value of all property located in any fire district in that county.

as a condition of its continuation in the program and identifying eligible positions that have been created. The report must be accompanied by a $1,500 fee, which is allocated among Commerce, Revenue, and OSBM. **Section 15.21** increases the reporting fee from $1,500 to the greater of $2,500 or .03% of an amount equal to the grant less the maximum amount to be transferred to the Industrial Development Fund.

Repeal of Economic Development Commissions.[125] Effective June 30, 2014, Section 15.28 abolishes the statutorily-created Regional Economic Development Commissions and would provide for an allocation of funds appropriated to the Department of Commerce related to the commissions. The section also provides for the distribution of assets held by the Eastern Region upon repeal that is consistent with the current statutory distribution of assets upon dissolution.

Currently, there are seven regional economic development organizations in North Carolina – four statutorily-created commissions and three public-private partnerships that are nonprofit entities. The three partnerships, which were established prior to 1993, are the Charlotte Regional Partnership, the Piedmont Triad Partnership, and the Research Triangle Regional Partnership.[126] The four statutorily-created commissions are: Advantage West Economic Development Group, North Carolina's Eastern Region, Northeast Commission, and Southeast Commission.[127] The General Assembly appropriates recurring funds to the regions. The Department of Commerce distributes funds to the regions based on a formula that incorporates tier county rankings. Tier ranks are based on unemployment, population growth, median household income, and property value per capita.

Modification to IDF and Utility Account. – **Section 15.18** eliminates the Industrial Development Fund and the Utility Account, as an account inside the fund, and establishes the Industrial Development Fund Utility Account. It also:

- Reverses the change enacted July 1, 2012, limiting IDF availability to the 65 economically distressed counties by expanding the program back to all development tier one and two counties.
- Modifies language requiring that funds be reserved only for projects that "will directly result in the creation of jobs" to projects "reasonably anticipated to result in the creation of jobs." Language regarding job retention has been eliminated.
- Modifies language requiring that funds be reserved only for projects in eligible industries (company HQ, air courier services, information technology/services, manufacturing, warehousing, and wholesale trade) by merely giving priority to such industries instead of funds being reserved to such industries.

REQUIRE CERTAIN GENERAL REAPPRAISALS.

Session Law	*Bill #*	*Sponsor*
S.L. 2013-362	**SB 159**	**Sen. Tarte, Rucho**

[125] This provision is similar to SB 127, which passed the Senate and is in House Commerce.
[126] These three regions formed as multi-county partnerships to combine growth efforts around the three largest metropolitan areas.
[127] In 1993, the General Assembly created four additional regions to market the rural areas of the State.

AN ACT TO CORRECT GENERAL REAPPRAISALS RESULTING IN PROPERTY VALUES THAT DO NOT COMPLY WITH THE REQUIREMENTS OF NORTH CAROLINA LAW BY SETTING FORTH THE STEPS REQUIRED TO BRING THE GENERAL REAPPRAISAL INTO COMPLIANCE WITH THE APPLICABLE PROPERTY TAX MANDATES.

SUMMARY: Session Law 2013-362 requires counties to retroactively change appraisals valued during the county's last general reappraisal if certain conditions are met.

PRIOR LAW: The value of real property must be appraised as of January 1 by each county at least once every eight years. Unless another standard applies for limited circumstances, the value to be determined is the true value of the property, or the price at which the property would change hands between a willing and financially able buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of all the uses to which the property is adapted and capable of being used. While there are limited exceptions, generally speaking, this value (i) must be used by the county until the county conducts its next general reappraisal and (ii) may not be changed for tax years other than the current tax year, regardless of whether the changes are sought by the taxpayer from the assessor, the board of equalization and review, or the board of county commissioners.[1] While G.S. 105-381 permits refunds or releases if the tax in question was levied illegally or due to clerical error and while G.S. 105-394 permits retroactive changes to property tax records to correct "immaterial irregularities" in the listing, appraisal, levy, or collection process, neither provision expressly authorizes retroactive changes to appraisals based on the alleged misjudgments of market value by the county.[2]

BILL ANALYSIS: This act adds a time-limited exception to the general rule that the assessed value may not be changed for tax years other than the current tax year by superseding the time limitations disallowing retroactive changes where the following conditions are met:

- The county has evidence that the majority of commercial neighborhoods reviewed by a qualified appraisal company possess significant issues of inequity.
- The county has evidence that instances of inequity or erroneous data had an impact on the valuation of residential neighborhoods in the county.
- The county's last general reappraisal was performed in one of the years when the economic downturn most severely affected home prices (2008-2012).

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[1] (See G.S. 105-287(c) (any change in appraisals made in non-general-revaluation years may take effect in the current tax year only and not retroactively; G.S. 105-296(i) (changes made informally by the assessor prior to the first meeting of the Bd of E&R may affect only current-year appraisals); G.S. 105-322 (authorizes board of E&R to make changes as permitted by G.S. 105-287 and as needed to resolve timely filed appeals of current year's appraisals); G.S. 105-325 (authorizes board of county commissioners to make changes only to current-year appraisals).

[2] Neither provision has been the subject of much litigation. The leading cases are *Ammons v. Wake County*, 127 N.C. App. 426 (1997), which makes clear that a misjudgment of market value under G.S. 105-381 cannot justify a refund under the "clerical error" standard but does not address the "levied illegally" standard, and *In re: Morgan*, 362 N.C. 339 (2008), which deals with immaterial irregularities. An argument that a misjudgment of market value was either an illegal tax or an immaterial irregularity would render the appeal deadline created by G.S. 105-322 unnecessary, and courts strive to avoid interpreting a statute in a manner that eliminates the relevance of another statute.

- The county's evidence (i) resulted from a review performed by an appraisal service retained and selected by the county and registered with the Department of Revenue and (ii) resulted from a sample size of not less than 375 properties that were examined on site.

If all of the conditions are met, the county must undertake one of the two following options:

- The county must conduct a general reappraisal pursuant to G.S. 105-286 within 18 months with at least 1 appraiser certified by the Department for mass valuations per 4,250 parcels.
- The county must have a qualified appraisal service expand the county's evidence of inequity to cover the entire county.

Once one of the two options has been completed, the county must change the abstracts and tax records so that the assessed value reflects the true value for each tax year until the next general reappraisal required by G.S. 105-286. In making these changes, the county must prioritize significantly overvalued parcels first, significantly undervalued parcels second, other overvalued parcels third, and other undervalued parcels last, and, in making refunds, the governing board of the county (and city, where applicable), must direct that a notice of refund and the refund amount be sent to the owner of record as of the date the payment was made. For overvalued parcels, the county must repay the overpayment with interest in the same manner as if there were an order of the Property Tax Commission reducing a valuation on property resulting in an overpayment under G.S. 105-290(b)(4), which is currently 5% per annum. For undervalued parcels, the additional taxes are treated as taxes on discovered properties pursuant to G.S. 105-312, on which interest does not begin to accrue until the next calendar date of delinquency, which would be the next January 6th. Penalties associated with discovered properties are expressly made non-applicable.

EFFECTIVE DATE: This act became effective when it became law by signature of the Governor on July 26, 2013.

BACKGROUND: In 2011, Mecklenburg County conducted a general reappraisal, which has been a source of controversy and debate. In response to a significantly higher rate of appeal and public criticism, the county commissioned a review of the reappraisal data. The resulting report indicated that many of the neighborhoods throughout the county had valuations that had either major or minor issues affecting the calculation.[3]

The report is available online at the following website:

http://charmeck.org/mecklenburg/county/AssessorsOffice/Pages/RevaluationReview.aspx

The act provides a remedy by conforming the previously established valuations to true or market values as of the date for which the reappraisal was to be effective coupled with a retroactive adjustment to tax liabilities. Laws amending property tax statutes must adhere to two North Carolina constitutional provisions:

[3] For example, in the neighborhood review, the report indicated major or minor issues in 49 of 150 neighborhoods, and in the land increase neighborhood review, the report indicated major or minor issues in 38 of 52 neighborhoods.

- Art. II, Sec. 24 of the NC Constitution prohibits local bills that "extend the time for the levy or collection of taxes or otherwise relieving any collector of tax from the due performance of his official duties."
- Art. V, Sec. 2 of the NC Constitution requires that any "classification" of property for tax purposes "be made by general law uniformly applicable in every county, city, and town."

North Carolina courts have not addressed the question of whether an act permitting or ordering the retroactive changing of property tax assessments in some (but not all) counties would violate either of these constitutional provisions. Although the act addresses primarily a local issue and Mecklenburg County is the only county known to meet all of the conditions set forth in the act, any county that conducted a revaluation between 2008 and 2012 can meet the act's conditions. A taxpayer or a county in the State may have standing to challenge a law that violated a constitutional provision. It is unknown whether a court would find the act to be local in nature or non-uniform.

MODIFICATIONS/2013 APPROPRIATIONS ACT.

Session Law	*Bill #*	*Sponsor*
S.L. 2013-363	**HB 112**	**Rep. Dollar, Collins, McElraft**

AN ACT TO MAKE TECHNICAL, CLARIFYING, AND OTHER MODIFICATIONS TO THE CURRENT OPERATIONS AND CAPITAL IMPROVEMENTS APPROPRIATIONS ACT OF 2013 AND TO RELATED LEGISLATION.

SUMMARY: Section 11.3 of S.L. 2013-363 extends the tax credit for renewable fuel facilities.

BILL ANALYSIS: S.L. 2013-363, Sec. 11.3, extends the sunset of the tax credit for constructing a renewable fuel facility from January 1, 2014, until January 1, 2017, if both of the following requirements are met:

- The taxpayer signs a letter of commitment with the Department of Commerce on or before September 1, 2013, stating the taxpayer's intent to construct and place into service in this State a commercial facility for processing renewable fuel.
- The taxpayer begins construction of the facility on or before December 31, 2013.

EFFECTIVE DATE: This section became effective July 24, 2013.

CHILDREN W/DISABILITIES SCHOLARSHIP GRANTS.

Session Law	*Bill #*	*Sponsor*
S.L. 2013-364	**HB 269**	**Rep. Jordan, Brandon, Jones, Stam**

AN ACT TO CREATE SPECIAL EDUCATION SCHOLARSHIP GRANTS FOR CHILDREN WITH DISABILITIES.

SUMMARY: S.L. 2013-364 would create \ special education scholarship grants for children with disabilities.

CURRENT LAW: A taxpayer is entitled to an education expenses tax credit of up to $3,000 per semester for tuition and special education and related services expenses for each

"eligible dependent child" who is a resident of North Carolina and who enrolled for one or two semesters during the taxable year in grades kindergarten-12 at either (i) a nonpublic school or (ii) a public school where tuition is charged for the child's enrollment. For home schools, the credit is equal to the amount the taxpayer paid for special education and related services expenses, not to exceed $3,000 per semester.

Qualifications for the Tax Credit. – In order for a child to be an "eligible dependent child," all of the following criteria must be met:

- The child must be a child with a disability who requires an individualized education program (IEP) under Article 9 of Chapter 115C of the General Statutes (Education of Students with Disabilities) and the federal Individuals with Disabilities Education Improvement Act (IDEA), 20 U.S.C. § 1400 et seq. (2004), as amended. The child must be reevaluated every three years by a local educational agency to verify that the child continues to be a child with a disability. Local educational agencies are not responsible for implementing IEPs for children in parentally placed nonpublic schools.
- The child must receive special education or related services on a daily basis.
- The child must be a child for whom the taxpayer is entitled to deduct a personal exemption under section 151(c) of the Internal Code for the taxable year.

For the initial eligibility for the tax credit during the first five years that the credit is available, the eligible dependent child must have been enrolled for at least the preceding two semesters in a public school or receiving special education or related services through the public schools as a preschool child with a disability. This initial eligibility requirement is reduced to one semester beginning for taxable years on or after January 1, 2016.

Disqualifications for the Tax Credit. – A taxpayer does not qualify for the education expenses tax credit for any semester when the taxpayer's otherwise eligible dependent child was:

- Placed in a nonpublic school or facility by a public agency at public expense.
- Enrolled for any time as a full-time student taking at least 12 hours of academic credit at a postsecondary educational institution.
- 22 years of age or older during the entire semester or graduated from high school prior to the end of the semester.

Reduction of the Tax Credit. – The amount of the education expenses tax credit is reduced for any semester in which the eligible dependent child spent any time enrolled in a public school. The amount of the reduction is equal to the percentage of the semester that the eligible dependent child was enrolled in a public school.

Carryforward of the Tax Credit. – Any unused portion of the credit may be carried forward for 3 succeeding years.

Fund for Special Education and Related Services. – The Fund for Special Education and Related Services (Fund) is a special revenue fund where monies in the Fund are to be used only for special education and related services for children with disabilities, to reimburse local educational agencies for conducting reevaluations for continued eligibility, and to develop revised individualized education programs for children with disabilities. At the end of each fiscal year, the Secretary of Revenue must transfer to the Fund from the net individual income tax collections an amount equal to $2,000, multiplied by the number of

education expenses tax credits taken during the fiscal year. Interest and other investment income earned by the Fund accrue to it and monies in the Fund do not revert.

BILL ANALYSIS:

S.L. 2013-264 repeals the current tax credit for children with disabilities as well as the Fund for Special Education and Related Services. It creates the following new program in Article 9 of Chapter 115C of the General Statutes (Education of Children with Disabilities). All terms defined for that Article will apply in this law, including the definitions for child with a disability, IEPs, and special education and related services.

Special Education Scholarship Grants (grants) – The program will provide grants of not more than $3000 per semester to eligible students for reimbursement of tuition and special education and related services. Priority will be given in awarding grants to students who received a grant in the previous semester. Otherwise, grants will be awarded to eligible students in the order in which applications are received.

Scholarship Grant Eligibility - A child with a disability under the age of 22 who meets all of the following requirements will be eligible for a scholarship grant:

- Requires an individualized education plan.
- Receives special education or related services on a daily basis.
- Has not been placed in a nonpublic school or facility by a public agency at public expense.
- Has not spent any time enrolled in a postsecondary institution as a full-time student taking at least 12 academic credit hours.
- Has not received a high school diploma.
- Meets one of the following requirements:
  - Was enrolled in a NC public school during the previous semester.
  - Received special education or related services through the NC public schools as a preschool child with a disability during the previous semester.
  - Received a scholarship grant for the previous semester, or received a tax credit for students with disabilities as provided in G.S. 105-151.33 for the fall semester of the 2013-2014 school year.
  - Is eligible for initial enrollment in kindergarten or the first grade in a NC public school.

Administration - The State Education Assistance Authority (SEAA) will administer the scholarship grants.

- **Timeline of awards** - Applications will be made available by May 1 to eligible students. Awards of grants for fall semester will be made by July 1, and awards for spring semester will be made by December 1.
- **Reimbursement Documentation** - At the end of each semester, parents will submit receipts or other documentation to the SEAA for reimbursement up to the maximum amount of the grant. Parents must provide documentation that the student was enrolled

in nonpublic school or was homeschooled and receiving related services for no less than 75 days of the semester for which the parent seeks reimbursement.

- **Verification of Eligibility** – The SEAA may seek verification on information on applications and may revoke grants if parents fail to cooperate with verification efforts. Parents must authorize the SEAA to access information held by the local educational agency.
- **Reevaluation** - After an initial award, students must be reevaluated by the local educational agency every three years to verify the student continues to be a child with a disability.

Reporting – The SEAA must report to the Joint Legislative Education Oversight Committee annually no later than October 1 on the following:

- Total number, age, and grade level of students receiving grants.
- Total amount of grant funding awarded.
- Nonpublic schools in which grant recipients are enrolled, and number of grant students at those schools
- Types of special education or related services for which grants were awarded.

Appropriations: $3,670,500 is appropriated to the SEAA for the 2013-2014 fiscal year, and $4,341,000 in recurring funds is appropriated to the SEAA for the 2014-2015 fiscal year to implement the act. SB 402 reserved funds for implementation of this act. Of those funds, $3,000,000 per year must be used by the SEAA to fund grants to eligible students. Unexpended funds do not revert and remain available to award grants. The remainders of the funds are transferred to DPI to conduct evaluation of eligible students. The SEAA may retain up to $200,000 of the funds for grants for administrative costs in fiscal year 2013-2014. For fiscal year 2014-2015 and subsequent years, the SEAA may retain 2% annually for administrative costs.

EFFECTIVE DATE: The repeal of the current tax credit (Sections 1, 2, and 3) is effective for taxable years beginning on or after January 1, 2014. The scholarship grant program (Section 4), is effective when it becomes law and applies beginning with the spring semester of the 2013-2014 school year. Sections 5 and 6, concerning appropriations and fund transfers, are effective July 1, 2013. Initial applications for the 2014 spring semester must be made available no later than October 1, 2014 and parents notified of awards as soon as practicable.

BACKGROUND: Approximately six states have scholarship grant programs for students with disabilities: Florida, Georgia, Louisiana, Ohio, Oklahoma, and Utah.

AMEND ASSESSMENTS FOR INFRASTRUCTURE NEEDS.

Session Law	*Bill #*	*Sponsor*
S.L. 2013-371	**SB 103**	**Senator Hartsell**

AN ACT TO EXTEND AND AMEND THE AUTHORITY COUNTIES AND CITIES HAVE TO USE SPECIAL ASSESSMENTS TO ADDRESS CRITICAL INFRASTRUCTURE NEEDS.

SUMMARY: ***S.L. 2013-371 addresses two issues in the special assessment for critical infrastructure needs that have arisen as local governments have considered its use. It also extends the sunset on this program for two years, from July 1, 2013, to July 1, 2015.***

CURRENT LAW: In 2008, the General Assembly gave counties and cities the opportunity to use special assessments on benefitted property as a financing tool for long-term capital projects. Although some local government units have considered using assessment-based financing[128] sometimes in conjunction with project development financing, no unit has done so to date. The ability to use this financing tool expired July 1, 2013.

Assessment-based financing may be used for any purpose for which project development financing may be used. Those purposes include water and sewer systems, public transportation facilities, school facilities, gas systems, electric systems, industrial parks, parks and recreation facilities, and streets and sidewalks. Special assessments may be pledged as additional security for project development financing debt instruments as well as revenue bond financing debt instruments. If the assessment is pledged to secure financing, the city or county must covenant to enforce the payment of assessments.[129] Special assessments must be paid in annual installments over a period not to exceed 30 years.

A county or city may only impose special assessments if it receives a petition for the project to be financed through assessments that meets a two-prong test:

- The petition must be signed by a majority of the owners of the property assessed.
- And those owners must represent ownership of at least 66% of the assessed value of the property to be assessed.[130]

The county board of commissioners or city must adopt a preliminary assessment resolution that describes the project, the proposed basis for making the assessment, and information concerning the cost of the work and the terms of payment of the assessment. The proposed basis for making the assessment method most accurately assess property according to the benefits conferred upon it by the project for which the assessment is made. The county or city must hold a public hearing on the matter, prepare a preliminary assessment roll, and publish a confirmation of the assessment roll once it is adopted. An owner of property against which an assessment is made may file a notice of appeal to the General Court of Justice if the owner is dissatisfied with the amount of the assessment.

BILL ANALYSIS: This act addresses three issues:

- An extension of the sunset date from July 1, 2013, to July 1, 2015.[131]
- An adjustment of the assessment in cases where the use of the benefitted property changes.
- Clarification as to how to apply the two-prong test to parcels of property owned by more than one person.

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[128] Iredell County may be considering the use of this financing tool in the near future.

[129] Unpaid assessments bear interest at a rate fixed in the assessment resolution. A county or city may foreclose assessment liens under procedures provided by law for the foreclosure of property tax liens.

[130] For example, if there are 21 owners involved and 10 hold 67% of the assessed value of the property to be assessed, at least one of the other 11 owners would have to sign the petition for the county or city to be able to impose the special assessments. Likewise, if 21 owners are involved and one owner owns 67% of the assessed value of the property, that one owner would have to be one of the signatures on the petition for the county or city to impose the special assessments.

[131] Senate Bill 104, also introduced by Sen. Hartsell, would repeal the sunset provision.

The original legislation enacted in S.L. 2008-165 contained a sunset date of July 1, 2013. Section 3 removes the sunset date from the effective date of the session law. Sections 1(a) and 2(a)[132] place the sunset provision in the statutes and extend the sunset date from July 1, 2013, to July 1, 2015.

One assessment method that may be used is one designed to allocate the costs in accordance with the benefits conferred. Sections 1(b) and 2(b) provide that the benefits conferred on an assessed property may be measured by how the property is used and that the assessment on that property may be adjusted over time if the use of the property changes. However, the assessment may not be changed unless the total amount of all the assessments is sufficient to pay the cost of the project after the adjustment is made.

Sections 1(c) and 2(c) address the two-prong ownership tests for properties owned by more than one person:

- A majority of the owners of the properties to be assessed must sign the petition. For purposes of determining a majority, each parcel of property is given one vote. The sole owner of a parcel is given one vote. Multiple owners of a parcel are given a percentage vote equal to one vote multiplied by a fraction, the numerator of which is one and the denominator of which is the total number of owners of the parcel.
- The petition signers must represent at least 66% of the properties to be assessed. For purposes of determining whether the assessed value represented by those signing the petition constitute at least 66% of the assessed value of all real property to be assessed, 100% of the assessed value of property owned by one person is included in the calculation. For property owned by more than one person, that person's proportionate share of the assessed value of that property is included in the calculation.

EFFECTIVE DATE: This act is effective June 30, 2013, and applies retroactively to special assessments imposed on or after that date.

UNC/REPORT/E-COMMERCE/IMPROVEMENTS.

Session Law	*Bill #*	*Sponsor*
S.L. 2013-375	**SB 485**	**Senator Apodaca**

AN ACT TO ELIMINATE A DUPLICATIVE REPORTING REQUIREMENT REGARDING PERSONAL SERVICE CONTRACTS FOR THE UNIVERSITY OF NORTH CAROLINA, TO ALLOW THE BOARD OF GOVERNORS TO PROVIDE FOR THE IMPLEMENTATION AND EXPANSION OF E-COMMERCE INFRASTRUCTURE, AND TO CLARIFY THE PROPERTY TAX STATUS OF CERTAIN IMPROVEMENTS ON UNIVERSITY LANDS THAT ARE OWNED BY CERTAIN SOCIAL ORGANIZATIONS.

SUMMARY: Session Law 2013-375 enacted the following:

- ***An elimination of a reporting requirement regarding personal service contracts for the University of North Carolina.***

[132] Section 1 makes the change in the statutes pertaining to counties and Section 2 makes the same change in the statutes pertaining to cities.

- ***Authority for the Board of Governors to implement and expand the use of electronic commerce infrastructure and capabilities among the constituent institutions.***
- ***A property tax exemption for improvements to real property that are owned by a university organization and located on land owned by one of the constituent institutions.***

ANALYSIS:

Each State agency reports annually to the Office of State Budget and Management on its use of personal services contracts exceeding $25,000; however, the utility of the reports have been questioned by constituent institutions of The University of North Carolina as those institutions try to become more efficient. **Section 1** of the act exempts The University of North Carolina from the reporting requirement.

Section 2 of the act allows the Board of Governors of The University of North Carolina to implement and expand the electronic commerce infrastructure among the constituent institutions in order to, among other things, allow use of common application programs as the institutions move towards electronic payment services.[133]

Section 3 of the act provides a property tax exemption for improvements made by a social fraternity, sorority, or similar organization on property owned by a constituent institution. The provision solves the tension under prior law that resulted in situations where property was exempt from property tax but the improvements built upon the property were not. Historically, the schools have owned the Greek housing. The exemption will encourage the Greek organizations to invest in the property and help the institutions defer investment in the housing.[134]

EFFECTIVE DATE: The property tax exemption in section 3 is effective for taxes imposed for taxable years beginning on or after July 1, 2013. The remainder of the act became effective when it was signed into law by the Governor on July 18, 2013.

MODERN STATE HUMAN RESOURCES MANAGEMENT/RTR.

Session Law	*Bill #*	*Sponsor*
S.L. 2013-382	**HB 834**	**Rep. Collins, Burr**

AN ACT ENHANCING THE EFFECTIVENESS AND EFFICIENCY OF STATE GOVERNMENT BY MODERNIZING THE STATE'S SYSTEM OF HUMAN RESOURCES MANAGEMENT AND BY PROVIDING FLEXIBILITY FOR EXECUTIVE BRANCH REORGANIZATION AND RESTRUCTURING AND TO IMPROVE TRANSPARENCY IN THE COST OF HEALTH CARE PROVIDED BY HOSPITALS AND AMBULATORY SURGICAL FACILITIES; TO TERMINATE SET-OFF DEBT COLLECTION BY CERTAIN STATE AGENCIES PROVIDING HEALTH CARE TO THE PUBLIC; TO MAKE IT UNLAWFUL FOR HEALTH CARE PROVIDERS TO CHARGE FOR PROCEDURES OR COMPONENTS OF PROCEDURES THAT WERE NOT PROVIDED OR SUPPLIED; TO PROVIDE FOR FAIR HEALTH CARE FACILITY BILLING AND COLLECTIONS PRACTICES; AND TO PROVIDE THAT HOSPITALS RECEIVING MEDICAID REIMBURSEMENTS PARTICIPATE IN THE NORTH CAROLINA HEALTH INFORMATION EXCHANGE NETWORK.

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[133] This section is especially meaningful to UNC-CH, UNC-W, and UNC-App. Without the legislation these institutions may have to discontinue the common application service they currently utilize and incur expense to build their own systems.

[134] This section is especially meaningful to NCSU. It has developed a new on-campus master planned Greek housing area to encourage on-campus fraternity and sorority housing.

BILL ANALYSIS: Part XII of S.L. 2013-382 prohibits The University of North Carolina (UNC) Health Care System and its affiliates, and other schools of medicine, clinical programs, facilities, and medical practices affiliated with one of the constituent institutions of UNC that provides medical care to the general public, from utilizing setoff debt collection procedures to collect outstanding debts from tax refunds and lottery winnings of debtors.

EFFECTIVE DATE: This Part becomes effective January 1, 2014, and applies to tax refunds determined by the Department of Revenue on or after that date.

REV LAWS TECHNICAL, CLARIFYING, & ADMIN. CHG.

Session Law	*Bill #*	*Sponsor*
S.L. 2013-414	**HB 14**	**Representative Howard**

AN ACT TO MAKE TECHNICAL, CLARIFYING, AND ADMINISTRATIVE CHANGES TO THE REVENUE LAWS AND RELATED STATUTES, AS RECOMMENDED BY THE REVENUE LAWS STUDY COMMITTEE.

SUMMARY: Session Law 2013-414 makes several technical, administrative, and clarifying changes to the revenue laws and related statutes.

EFFECTIVE DATE: Except as otherwise provided, the act became effective when it was signed by the Governor on August 23, 2013.

BILL ANALYSIS:

Section	Explanation
REVENUE LAWS RECOMMENDATIONS	
1	Corrects several references to "reports and statements" where there is no longer a requirement to submit a statement and substitutes the more appropriate term "return." Also replaces "make" or "making" a return with "file" or "filing." Makes other grammatical and stylistic changes to conform to drafting conventions.
2	Deletes a statutory reference due to repeal of another subsection.[135]
3	Corrects reference to period of underpayment to reflect the change in the due date of the corporate return from the third month (March 15) to the fourth month (April 15).

[135] In S.L. 2010-89, the General Assembly provided an alternative apportionment formula for a corporation that signed a letter of commitment by September 15, 2010, certifying that it planned to invest at least $500 million in private funds to construct a facility in a development tier one area. No company signed such a letter. The General Assembly enacted the provision at the request of Microsoft; Microsoft announced in August of 2010 that it would be locating in Virginia. Since the alternative apportionment formula provided in G.S. 105-130.4(t2) and G.S. 105-122(c1)(3) was no longer needed, the General Assembly repealed those provision in S.L. 2011-330, s. 5. Therefore, the references to the repealed subdivisions in G.S. 105-122(c1)(2) and G.S. 105-130.4(t1) should be deleted.

4	Corrects reference to the proper carryforward period under Article 3J when a taxpayer fails to qualify for an extended carryforward period due to a large investment.[136]
5	Makes technical corrections related to the shift from taxable income to AGI as the starting point for determining NC taxable income.[137]
6	Ensures that relevant transitional adjustments under G.S. 105-134.7 are retained by adding them to G.S. 105-134.6 with corresponding changes throughout.
7	Makes technical changes to the Credit for the Disabled.
8	Amends definitions related to the Streamlined Agreement and adjusts the definition of "storage" to clarify that the purchaser must know the original purpose and location where items will be used at the time of purchase.
9	Amends the facilitator reporting requirements to recognize various business practices and recordkeeping by facilitators. The Department was advised that some facilitators provide a credit card number for use by the hotelier before, during, or after the rental of accommodations.
10	Clarifies that a credit is allowed for use tax if the tax is shown on the invoice or other documentation issued by the retailer.
11	Makes various changes to certain sales tax exemptions: (26), (26a), (27), (31a), & G.S. 105-164.13A [138] Adds "prepared food" to various sales tax exemptions to modernize the language as a result of the adoption of definitions for Streamlined purposes and reflects the fact that schools sell both food and "prepared food." (33a): Clarifies that the sales and use tax exemption for tangible personal property delivered by the retailer for use outside the State applies to certain printed material. This exemption was adjusted during the 2011 Session at the request of the Department to add "by the retailer." However, additional adjustments are needed to retain the exemption for printed material that is not delivered by the retailer to

[136] The Article 3J credits for creating jobs and for investing in business property have a 5-year carryforward period and the credit for investing in real property has a 15-year carryforward period. S.L. 2012-74 temporarily allows for a 20-year carryforward period under Article 3J for a taxpayer who makes an investment of $100 million in business and real property in a tier one county.

[137] Section 31A.1 of S.L. 2001-145 changed the starting point for calculating NC taxable income from federal taxable income to federal adjusted gross income. This change did not change the tax base or increase NC tax in any way.

[138] These changes were requested by the Department after the introduction of the bill and were not included in the original Revenue Laws recommendation.

	the United States Postal Service or that is not purchased with a direct pay permit.[139] (43a): Amends the exemption for computer software "designed to run on an enterprise server operating system." The inclusion of the term "designed" has been problematic. The Department issued an "Important Notice" in February 2010 in an attempt to further clarify this issue. At issue are products that are designed but may not be run on an enterprise server operating system. It is burdensome for the Department to attempt to determine if the products meet the "designed" requirement. (57)[140] Clarifies that in order for the exemption for fuel and electricity sold to a manufacturer to apply, the facility must be *primarily* engaged in manufacturing.
12	Makes three changes to the sales tax refund statute for nonprofit entities. • Provides that sales and use tax liability indirectly incurred by a nonprofit entity through reimbursement to an employee of the entity for the purchase of tangible personal property and services for use in carrying on the work of the nonprofit entity is considered a direct purchase by the entity. • Replaces the term "medicines" with "over-the-counter drugs" in the statute that permits a refund of sales and use taxes to nonprofit entities and hospitals. • Clarifies that a single member LLC that is disregarded for federal income tax purposes qualifies for a refund if the owner of the single member LLC is a 501(c)(3) and the LLC engages in qualifying activities.
13	Ensures that statute is consistent with the Sales and Use Tax Technical Bulletin Section 46-1 E., which provides that the issuance of a direct pay permit to avoid payment of State and local sales taxes levied on hotel accommodations is a prohibited use. Adds a provision requiring a person who purchases direct mail under a direct pay permit to file a return and pay the tax due monthly or quarterly to the Secretary.
14	Repeals G.S. 105-164.35, which authorizes the Secretary to recompute sales and use tax if, after examining a return, he determines the correct amount of tax is greater or less than the amount shown on the return and to credit or refund excessive payments. This statute, which is specific to sales and use tax, is unnecessary because G.S. 105-241.7 gives the Secretary this authority for all tax types.

[139] The proposed language tracks the language that is in Sales and Use Tax Bulletin 7.
[140] This change was requested by the Department after the introduction of the bill and was not included in the original Revenue Laws recommendation.

15	Provides liability relief to retailers for erroneous information provided by the Department regarding the taxability of certain items or insufficient notice regarding a sales tax rate change as required by the Streamlined Agreement.
16	Clarifies that the credit allowed under Article 5F for similar tax paid to another state also applies to sales and use tax paid in this State and not just paid to another state.
17	Corrects references to Department Divisions based on reorganization. Adds various forms of identity theft to the subject matter jurisdiction of revenue law enforcement officers. Generally speaking, revenue law enforcement officers have the authority to serve and execute notices, orders, warrants, and demands, have full powers of arrest, and must be certified as criminal justice officers.
18	Deletes obsolete provision. The Secretary no longer makes a final agency decision in contested tax cases. Substantive final decisions are published on the OAH website.
19	Amends the secrecy statute as follows: (15a): Modifies the circumstances under which the Department may share information with law enforcement agencies. On occasion, the Department has shared information with the IRS or another taxing jurisdiction under G.S. 105-259(b)(3) that is connected to a criminal investigation. However, some of the information shared may be information that is not "discovered" in the course of the investigation (i.e. audits that occurred prior to the criminal investigation that led the Department to initiate the criminal investigation). While those records may be shared with other taxing agencies (i.e. the IRS) under (b)(3), there may not be specific authorization to share the information with prosecutors (i.e. the US Attorney) who later are working on the criminal case. In addition, the change gets rid of awkward language regarding who may receive the information. The Department has agreements with all agencies with whom it is allowed to share information listing the specific individuals allowed to receive the information. A literal reading of the current language would allow the Department to share the info only with the head of the agency. It clarifies that a prosecutorial agency is a law enforcement agency. Finally, it allows the share of information with local law enforcement or law enforcement from another state. (25)[141] Permits the Department to include a retailer's registration number in the public database of retailers who are authorized to collect sales and use tax. The Department already maintains a publicly accessible database listing the names of retailers authorized to collect sales and

[141] This change has been requested by the Department since the introduction of the bill and was not included in the original Revenue Laws recommendation.

	use tax. Many sellers use the online registry to verify sales and use tax numbers provided by customers who present an exemption certificate. (29): Corrects a citation and statutory reference.[142]
20	Conforms payment for TIMS to current practice. The language in the 2012-13 budget bill differed from standard practice used by DOR since the beginning of benefits funding for the project. Technically, OSBM authorizes DOR to make purchases rather than making those purchases itself.
21	Modifies the circumstances under which the Department may share information regarding the unauthorized substances tax. The current restriction on disclosure could prevent Department employees from sharing information in situations that do not present concerns about Constitutional protections for criminal defendants like double jeopardy or self-incrimination such as: • A prosecutor investigates allegations of law enforcement unlawfully seizing property from specific individuals. Law enforcement personnel report the property has been turned over the Department to satisfy a tax debt. • A prosecutor requests information from the Department in order to satisfy his obligation to provide the defendant in a criminal case with potentially exculpatory information. • A Department employee serving a tax warrant witnesses a crime committed by the taxpayer against a third party.
22	Subsection (a) clarifies the procedure and requirements for obtaining a license for the distribution of tobacco products and provides the Department with specific guidance as to when a license may be denied. This subsection also requires the Department to include certain information on the face of each license, and directs the Department to keep a record of license holders that may be provided to other license holders upon request. Subsection (b) clarifies the violations for which the Secretary, after a hearing, may cancel a license for the distribution of tobacco products. Subsection (c) clarifies a distributor of cigarettes may provide security to the Secretary in the form of an irrevocable letter of credit as an alternative to a bond. This subsection also deletes a redundant provision for investigation of license applicants. This section became effective September 1, 2013.

[142] Part 2F of Article 10 of Chapter 143B relates to the E-NC Initiative and has been repealed.

23	Makes changes to the sourcing of direct mail to comply with Streamlined requirements. Under current law, direct mail is sourced to the location from which it is shipped unless it was purchased using a direct pay permit or the purchaser provides the seller with information showing the jurisdictions to which the mail is to be delivered. In those instances, the mail is sourced to the delivery location. Under the Streamlined Agreement, direct mail categorized into "advertising and promotional direct mail" and "other direct mail." The current law as stated above is accurate except that "other direct mail" (direct mail other than advertising and promotional direct mail) should be sourced to the purchaser's address available from the seller's business records if the mail is not purchased using a direct pay permit or if the purchaser does not provide the seller with jurisdictional delivery information.
ADDITIONAL CHANGES	
30	Corrects a citation.
31	Clarifies that Department personnel have the right to access a specialty market registration list. This clarification will assist with compliance checks by Department employees and provide clear direction that operators are required to obtain and provide information to assist with administration and collection of sales tax at events.
32	Adds a sunset to 105-129.16H, which is the credit for donating funds to a nonprofit or unit of State or local government to enable that entity to acquire renewable energy property. G.S. 105-129.16A, which is the credit for investing in renewable energy property, currently has a sunset of January 1, 2016. The same sunset is implied for G.S. 105-129.16H to the extent the credit is tied to G.S. 105-129.16A; that is, G.S. 105-129.16H allows the same credit when the purchaser of renewable energy property is a nonprofit that is not subject to income tax.
33	Deletes the word "large" from the statute. This is a technical change because the credit for large recycling facilities was repealed by S.L. 2010-166.[143]

[143] The repeal of this credit was a recommendation of the Revenue Laws Study Committee because the incentive was never utilized. The credit was intended for Wisconsin Tissue; however, that company never located in North Carolina.

34	Consolidates the bonus depreciation and section 179 expensing provisions related to decoupling from the Code into a new, stand-alone statute. However, G.S. 105-130.5B(c) and G.S. 105-134.6A(c) contain a drafting error that needs to be corrected. Those subsections state that the investment limitation for tax year 2013 is $125,000 when it should be $200,000. It is anticipated that the General Assembly will make this correction in the 2014 Session. Provides that in the event of a transfer of assets, instead of taking any remaining bonus depreciation deductions, the transferee adds the amount of any remaining deductions to the basis of the transferred asset.
35	Effectuates intent of IRC Update (S.L. 2013-10) by clarifying that charitable deduction is not subject to charitable contribution limitation and carryover provisions but is subject to the overall limitation on itemized deductions under section 68 of the Code.
36	Makes conforming changes required by the fact that G.S. 105-130.6, which dealt with forced combinations, was repealed in 2011 and replaced with a new statute. The definitions for "subsidiary" and "affiliate" are the same definitions that were in G.S. 105-130.6.
37	Modifies the individual income tax credit for charitable contributions by non-itemizers for tax year 2013 by including in the taxpayer's excess charitable contributions the amount by which the taxpayer's charitable contributions for the taxable year would have been deductible under Section 170 of the Code had the taxpayer not elected to take the income exclusion under Section 408(d)(8) of the Code that exceed two percent of the taxpayer's adjusted gross income.
38	Makes a technical change to reflect the fact that the starting point for calculating North Carolina taxable income is adjusted gross income.
39	Gives the Department flexibility in requiring electronic submissions.
40	Makes the sales tax imposition statute for digital property mirror the sales tax imposition statute for tangible personal property to make clear that the imposition of sales tax on digital property includes lease or rental. This is a technical change.
41	Adds the word "product" to the sourcing provisions for mobile telecommunications, which currently covers only services. This change was recommended by Streamlined in light of the fact that under the federal Mobile Telecommunications Sourcing Act, sales of certain digital products, such as a ringtone, is adjunct to mobile telecommunication service and is, therefore, sourced under the mobile sourcing provisions.

42	Clarifies that joint library systems that serve two or more counties, or counties and cities, are allowed the sales and use tax refund as a public library.[144] Currently, the sales and use tax refund for public libraries applies only to public libraries created by act of the General Assembly. While most libraries are part of a city or county government and receive the refund due to the county/city refund provision, some libraries were chartered by an act of the General Assembly.[145] A public library may also be established jointly by two or more counties or cities and counties under general authority granted in G.S. 153A-270. This provision would allow libraries created pursuant to this general authority, in addition to those created by a specific local act of the General Assembly, to be eligible for a sales and use tax refund.
43	Rewrites the provision dealing with a certificate of exemption for sales tax purposes in light of changes adopted by the Streamlined Governing Board. Among the changes is the requirement that a retailer must pay within 90 days sales tax on a transaction unless it obtains a fully completed exemption certificate, or within 120 days upon audit.
44	Allows the Secretary of Revenue to authorize the Streamlined Sales Tax Governing Board to contract, on behalf of the Secretary, with a certified service provider for the collection and remittance of sales and use taxes on behalf of the seller.
45	Makes a technical change to the distribution of part of the sales tax on video programming service and telecommunications service to counties and cities. In 2010, the General Assembly repealed the PEG Grant Fund and increased the revenues from the video programming sales tax designated for Supplemental PEG channel support to $4 million per year.[146] However, the distributional section of the statute was not amended accordingly and still refers to $2 million.
46	Modernizes the language and clarifies that the activities at the establishment must fall within the applicable NAICS code.

[144] **§ 153A-270. Joint libraries; contracts for library services.**
Two or more counties or cities or counties and cities may establish a joint library system or contract for library services, according to the procedures and provisions of Chapter 160A, Article 20, Part 1.

[145] The Public Library of Charlotte and Mecklenburg County was chartered in 1903 by act of the General Assembly.

[146] S.L. 2010-158.

47	Codifies the Department's administrative practice of allowing protective refund claims. Generally speaking, there is a time limit within which a taxpayer may file a claim for refund. If the claim for refund is not timely filed, it will be barred. Occasionally, a taxpayer's right to a potential refund is based on a contingent event, such as pending litigation or an ongoing income tax audit in another state, for a taxable period for which the statute of limitations is about to expire, and the outcome of that event may affect the North Carolina tax liability. The Department has administratively allowed for a taxpayer in these circumstances to file a timely but incomplete claim for refund, known as a "protective refund claim," and then later perfect the claim when the essential information becomes available. The new provision requires the taxpayer to file the claim within 6 months of the conclusion of the contingent event. Under prior practice, there was no stated timeline for filing a protective claim. The taxpayer is also required to indicate an estimated amount of the overpayment. Previously, an estimate was not required.
48	Clarifies when a person may object to a proposed rule related to the Secretary's authority to require a combined return and request review by the Rules Review Commission (RRC). The rulemaking process allows an agency to change the text of a proposed rule in response to comments and objections raised during the public hearing and comment period, but a person should not be able to subject a rule to RRC review until the agency has adopted the rule. Under this rewrite, a person may only subject the rule to RRC review after the agency has adopted the rule rather than prior to its adoption.
49	Clarifies that it is the intent of the General Assembly to harmonize the language of the local statutes to be consistent with the State sales and use tax statues. These changes clarify that the local statutes are intended to be consistent with G.S. 105-164.8(c) relative to imposition of tax and destination sourcing requirements.

50	Allows a regional public transportation authority created under Article 26 of Chapter 160A[147] to create a special district consisting of one or more counties within its territorial jurisdiction to levy an annual license tax upon any motor vehicle in its jurisdiction to raise revenue for capital and operating expenses of the Authority in providing public transportation systems. Under prior law, regional public transportation authorities can only levy the tax if all counties in the region agree to the tax. Regional transportation authorities created under Article 27 of Chapter 160A[148] already have the authority to levy the tax if less than all of the member counties approve the tax.
51	Codifies Departmental policy promulgated in an Important Notice dated June 30, 2011, that lease receipts billed on or after July 1, 2011, are subject to the 4.75% State rate of sales tax instead of the 5.75% State rate of sales tax, regardless of the fact that the lease was entered into for a definite period of time prior to July 1, 2011, at which time the rate was 5.75%.[149]
52	Makes two clarifying changes regarding the retention by the Department of Revenue of the 911 surcharge for the first year of implementation. S.L. 2011-122 authorized collection of the 911 service charge for prepaid wireless service at the point of retail sale. Although the charge is not a tax, it is collected by the Department of Revenue. To offset the cost of collection, the Department is authorized to retain the cost of collection below a cap. This section clarifies the first year cap applies to the surcharge collected by the retailers in the first year. Due to the delay of the remittance, not all of the charges collected by retailers in the first 12 months will be remitted to the Department in those first 12 months. This section also clarifies that the Department may retain costs incurred by the Department prior to the effective date of the surcharge. In order to ensure compliance, the Department has mailed notification of the law change to all entities that remit the 911 surcharge prior to the effective date of the surcharge.

[147] This Article applies to the Research Triangle Regional Public Transportation Authority, better known as Triangle Transit or TTA, which is a three-county regional public transit agency serving Wake, Durham and Orange Counties.

[148] This Article applies to the Piedmont Authority for Regional Transportation (PART), which provides inter-city and regional public transportation for the Greensboro, Winston-Salem and High Point, NC area.

[149] S.L. 2009-451 provided for a temporary 1% State sales tax increase (to 5.75%) with a July 1, 2011 expiration date. Without further legislation action, the State sales tax rate returned to 4.75% on July 1, 2011.

53	Requires the Department of Revenue to allocate and distribute to cities and counties the amount equal to the average of the local sales and use taxes that was allocated and distributed to them in the preceding three fiscal years if the Department cannot accurately identify and calculate correct amounts for distributions payable in fiscal year 2014-15 because of implementation issues with the Tax Information Management System (TIMS).
54	Expands eligibility for a refund of sales and use taxes to include volunteer fire departments and EMS squads that are financially accountable to a city, a county, or a group of cities and counties and not merely those that are exempt from income tax under the Internal Revenue Code. The IRS treats entities that are financially accountable to a city or a county as tax exempt without any formal determination process. This section modifies the refund statute to match the current IRS practice and allow refunds to entities that would be treated by the IRS as tax exempt under the Internal Revenue Code. The NC Department of Revenue (DOR) has administratively ruled that some volunteer fire departments and volunteer EMS qualify for refunds of sales and use tax because the entities are financially accountable to a city or a county. This provision became effective July 1, 2013, and applies to purchases occurring on or after that date.
55	Makes technical citation changes.
56	Provides that a responsible person in a business entity is personally and individually liable only for the principal amount of taxes owed by the business entity. As recommended by the Revenue Laws Study Committee, the original bill included a proposal to clarify that penalties and interest, in addition to the principal amount of taxes, transfers to a responsible officer in a business entity that fails to pay taxes owed. During discussion in House Finance, the bill was amended to delete this provision, the intent being that a responsible officer should not be liable for penalties and interest. This provision more clearly effectuates that intent by specifically stating that the responsible person may only be liable for the principal amount of taxes owed. This provision became effective when the act became law on August 23, 2013, and applies to assessments proposed on or after that date.
57	Authorizes a new special registration plate for the North Carolina Paddle Festival. The plate costs $30, and the proceeds go to the Friends of the Hammocks and Bear Island, Inc.

58	Makes a series of technical and conforming changes to conform to the passage of S.L. 2013-316 (H998). Subsection (a) incorporates the changes made by Section 34(d) of this act. Subsection (b) repeals reporting requirements that are no longer necessary because the tax credits for which the information is needed have been eliminated. Subsection (c) corrects statutory references. Subsection (d) maintains the current authority cities have to impose a local privilege tax on live entertainment. Under current law, a local tax may not exceed $25. Without this clarification, a city's authority to impose a privilege tax on live entertainment could be interpreted to be more expansive than current law. Subsection (e) does two things: (1) it defines the term "State attraction" for purposes of the sales tax exemption as a physical place supported with State funds that offers cultural, educational, historical, or recreational opportunities, and (2) it exempts from sales tax a service contract provided for an item purchased by a professional motorsports racing team for which it is allowed a sales tax refund under current law.
OCCUPANCY TAX CHANGES	
60	Makes technical changes to various local occupancy tax acts so that they conform to changes made to the Uniform Provisions for Room Occupancy Taxes. In 2010[150] the General Assembly amended the uniform provisions governing occupancy tax to provide that room occupancy tax applies to the same gross receipts as the State sales tax on accommodations and is calculated in the same manner as that tax. The legislation further provided that to the extent this provision conflicts with any provision of a local act, the general law supersedes the local provision. Therefore, the changes in this section are technical because to the extent they conflict with State law, they have been superseded by the 2010 legislation. Specifically, there is no State sales tax exemption for businesses that rent fewer than five units, and the exemption for summer camps is not needed because they are already exempt under State law. The other deletions also reflect the application of State sales tax on accommodations. The table below shows the localities impacted because their legislation either imposes an occupancy tax on campgrounds/campsites or exempts from occupancy tax all or some combination of the following: • A business that offers to rent fewer than five units • Summer camps • Religious organizations • Educational organizations • Charitable, benevolent, and other nonprofit organizations

Counties		Cities
Alamance	Johnston	Goldsboro
Alleghany	Lenoir	Greensboro
Buncombe	Madison	Kinston

[150] Section 31.6 of S.L. 2010-31.

		Carteret Craven Currituck Dare Forsyth Guilford	Martin Onslow Richmond Washington	Washington

TAX & TAG TOGETHER MOTOR VEHICLE PROPERTY TAX SYSTEM CHANGES	
In 2005, the General Assembly created a framework establishing a combined system for motor vehicle registration renewal and property tax collection. Originally, the act was to become effective the earlier of January 1, 2009, or the date that the Department of Revenue and the Division of Motor Vehicles certified that an integrated computer system is in operation. The effective date was subsequently extended, and the system went into effect July 1, 2013. Under the new system, the taxpayer/motor vehicle owner will receive one bill for property taxes and the DMV license renewal, and DMV will be the collecting authority. Counties will still determine the value and the taxability situs of motor vehicles. A number of conforming changes are needed to fully implement the combined system. Sections 70-72 of this act consist of those changes.	
70	Makes two changes to the effective dates of the acts that establish the combined system: • Removes conditional language. – The current effective date for the combined system contained a conditional clause that allowed the system to be effective earlier than July 1, 2013, if the integrated computer system was operational. The system went online as of July 1, 2013. Therefore, the conditional clause is deleted from the effective dates. • Clarifies local government authority. – Although the tax year for registered motor vehicles does not change under the combined system, the collection date for property taxes is earlier under the combined system. For the months of July, August, and September, local governments will send bills for tax years that begin on or before September 1, 2013. During those same months, the Tax and Tag Together system will begin to send bills for tax years that begin after September 1, 2013. The effective date is amended to clarify local government authority to collect property tax for tax years beginning on or before September 1, 2013, under the statutes as in effect June 30, 2013.
71	Repeals certain prior technical and conforming changes that are now inconsistent with the statutes since they became effective July 1, 2013, and recodifies the necessary technical changes. Over eight different session laws have amended the Tag and Tax Together system. The effective date for the system has also been changed at least three times. The combination of the multiple changes has made further technical changes difficult to make.
71(a)	Repeals inconsistent changes.

71(b)	Clarifies the appeals process for motor vehicle property tax. A taxpayer may appeal motor vehicle taxes on a number of grounds: the valuation by the county, the denial of an application for exemption or exclusion, and on the grounds that the county does not have authority to tax the vehicle because the situs of the vehicle is in another taxing district. The term "taxability" in the appeal statutes has been used to refer to both exemption status and situs, but because there are different time periods that apply depending on the basis of a taxpayer's appeal, the Department recommends separating the statutory provisions.[151] Therefore, this section strikes the term "taxability" from G.S. 105-330.2(b1) so that, as amended, this subsection would apply only to appeals based on valuation. It also creates a new subsection (b2) to address appeals based on an application for exemption or exclusion. Appeals based on a county's authority to tax are covered under current law in G.S. 105-381.
71(c)	Establishes a process for the collection of property tax on an unregistered vehicle. The objective of the process is to ensure that the taxpayer is not double-taxed and that property taxes are paid on motor vehicles that a person owns even if it is not registered. If a person does not register or renew registration, then the person would be required to list the vehicle with the county assessor. The listing will generate a tax bill. However, if the person subsequently registers or renews the tag for the vehicle, then DMV will charge the person for the registration plus the property tax. This provision allows a county to ignore the listing to the extent the person registered or renewed within the same year.
71(d)	Clarifies that counties would have authority to use collection remedies for unpaid motor vehicle taxes that were billed prior to the effective date of the combined motor vehicle/property tax system. With a July 1 effective date, the first bills sent under the combined system will be for September registration renewals. The October 1st date is used because the tax year for September renewals begins October 1. It allows 45 days before the second month's interest begins. This is needed due to DMV's business process which DOR thinks may cause some taxpayers who pay by mail to get caught in a loop of sending in the payment after the due date, and the payment would be rejected. Without this change, the next month's interest would start before they got the correct amount mailed back in to DMV. This section also changes the term "tax collector" to "collecting authority" because under the new system, DMV and not the county tax assessor or tax collector will be the collecting authority.

[151] A taxpayer has 30 days to appeal a determination of value or eligibility for an exemption or exclusion. However, there is a five-year period to appeal an "illegal" tax under G.S. 105-381.

72	Allows vehicles of victims of domestic violence, sexual offense, stalking, or human trafficking vehicles to be billed as other personal property, keeping the addresses confidential. Chapter 15C of the General Statutes establishes an Address Confidentiality Program to protect the confidentiality of the addresses of victims of domestic violence, sexual offense, stalking, or human trafficking. If these vehicles were taxed under the combined system, the address would not be confidential.

2012

Extend Tax Provisions.

Session Law	*Bill #*	*Sponsor*
S.L. 2012-36	**HB 1025**	**Rep. Howard, Starnes**

AN ACT TO EXTEND THE SUNSET OF CERTAIN TAX PROVISIONS.

OVERVIEW: This act extends several preferential tax provisions.

FISCAL IMPACT: The act will reduce General Fund revenues by $0.8 million in fiscal year 2012-2013. *(For a more complete fiscal analysis, see Finance Committee Highlights, 2012 Session, available online at www.ncleg.net.)*

EFFECTIVE DATE: This act became effective when the Governor signed it into law on June 20, 2012.

ANALYSIS: North Carolina typically imposes a sunset on its tax credits, deductions, and refunds so they may be periodically reviewed to ensure they continue to achieve the policy goals intended. It is anticipated that major tax modernization will be undertaken during the 2013 session of the General Assembly. This act extends several preferential tax provisions through 2013 in order to maintain the current state of the North Carolina tax code until comprehensive tax modernization can be considered. The only credits extended beyond the 2013 taxable year were the income tax credits for rehabilitating historic structures and historic mill property[152] and the film credit,[153] which were extended through the 2014 taxable year.

Specifically, the act extends the tier one designation for seafood industrial parks through July 1, 2013. It extends the following income tax credits through January 1, 2014:

- Tax credit for renewable fuel facilities.
- Tax credit for biodiesel producers.
- Work opportunity tax credit.
- Article 3J tax credits.
- Tax credit for recycling oyster shells.
- Tax credit for premiums on long-term care insurance.
- Refundable earned income tax credit.
- Tax credit for adoption expenses.

[152152] Section 12 of the act.
[153] S.L. 2012-194.

- Tax credit for qualified business ventures. Lastly, it extends the following sales tax refunds through January 1, 2014:
- Passenger air carriers.
- Machinery and equipment place in a tier 1 county.
- Aviation fuel for motorsports team of sanctioning body.
- Analytical services.
- Certain industrial facilities.

Expedited Rule Making for Forced Combination.

Session Law	*Bill #*	*Sponsor*
S.L. 2012-43	**SB 824**	**Sen. Rucho, Hartsell**

AN ACT TO REQUIRE THE SECRETARY OF REVENUE'S INTERPRETATION OF THE LAW CONCERNING THE SECRETARY'S AUTHORITY TO ADJUST NET INCOME OR REQUIRE A COMBINED RETURN BE MADE THROUGH RULE MAKING AND TO PROVIDE AN EXPEDITED PROCESS FOR RULE MAKING ON THIS ISSUE.

OVERVIEW: This act requires the Department of Revenue to adopt rules regarding its interpretation of the statute enacted in 2011[154] that gives the Secretary of Revenue the authority to force combination of separate entity returns. The act provides an expedited rule-making process for these rules. The legislation was a recommendation of the Revenue Laws Study Committee.

FISCAL IMPACT: This act has no fiscal impact.

EFFECTIVE DATE: This act became effective when the Governor signed it into law on June 14, 2012.

ANALYSIS: The issue of forced combination of separate entity returns began as a dispute between taxpayers and the Department of Revenue. Taxpayers have argued that the Department offered little to no guidance on how it interpreted the statutes that authorized it to force combination of separate entity returns. The N.C. Court of Appeals affirmed the Department's authority to force combination of separate entity returns in *Wal-Mart Stores East, Inc. v. Hinton*.[155] Although the Business Court upheld the Department's combination assessment against Delhaize in 2011, it struck the penalties imposed by the Department on the taxpayer for failure to file the combined return because it noted that the Department "worked actively to conceal the standards its decision makers were using when exercising their authority to combine returns."[156]

Largely in response to this litigation, the General Assembly enacted legislation in 2011 repealing the statute upon which the Department derived its authority to force combination of

[154] G.S. 105-130.5A.
[155] 197 N.C. App. 30 (2009).
[156] *Delhaize America Inc. v. Lay,* 06 CVS 08416 (Wake County Superior Court, Jan. 12, 2011), on appeal as, *Delhaize America, Inc. v Hoyle*, NC Ct of Appeals Docket No. 11-868.

separate entity returns and replaced it with more limited statutory authority.[157] The Department issued the first Corporate Tax Directive[158] it has issued since 2008 on the Secretary's authority to require a corporation to file a combined return under the new statute. The Revenue Laws Study Committee discussed the directive and how the Department administers its discretionary authority.[159] Throughout the hearings, the Committee expressed strong concerns on the need for the Department to provide clarity on the law for taxpayers and a belief that the guidance should be provided through the rulemaking process, especially on the issue of forced combinations. The Department voiced strong concerns about its ability to effectively and efficiently administer the tax laws if it had to undertake rulemaking for all of the guidance it provides. In the debate, the Committee identified three goals:

- The need for taxpayer certainty about the tax laws.
- The need for an outside determination as to whether the Department has exceeded its statutory authority in its interpretation of the law.
- The opportunity for public notice and comment on the Department's interpretation of the law.

This act seeks to balance these three goals. It requires the Secretary to adopt rules providing guidance to taxpayers on its administration of G.S. 105-130.5A, the newly enacted law regarding the Secretary's ability to redetermine a corporation's State net taxable income by adjustment or by forced combination. The act does not extend the rulemaking requirement to all interpretations of the tax laws by the Department because the Revenue Laws Study Committee did not have time to resolve the issues a larger proposal would entail; however, legislators have expressed a desire to consider a more far-reaching rulemaking requirement.

The act provides that the rulemaking procedure for the interpretation of G.S. 105-130.5A will follow the timetable for temporary rulemaking. This process may be completed in less than two months. This process allows 15 days for notice and comment from outside parties. Anyone may object to a proposed rule during the notice and comment period or within three business days of the adoption of the rule by requesting review by the Rules Review Commission (RRC). To ensure that all parties have knowledge of the adoption of a rule, the act requires the Department to provide electronic notification of its adoption of a rule to persons who are on the mailing list, who were originally given notice of the rulemaking, and who provided comment on the rule. If no one requests review by the RRC, the adopted rule may be delivered to the Codifier of Rules and entered into the Code. If the Department receives a written objection to the rule and a request that the rule be reviewed, then the RRC must review the rule within 15 days. The RRC may not extend the period of time for review. As provided in G.S. 150B-21.9, the RRC does not consider questions relating to the quality or efficacy of the rule, but limits its review to the following:

- Is the rule within the authority delegated to the agency?
- Is it clear and unambiguous?

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[157] S.L. 2011-390, G.S. 105-130.5A.

[158] Corporate Income Tax Directives Table of Contents

[159] Revenue Laws Study Committee Report (2012), see "Combined Reporting and Interpretation of Tax Laws" beginning on page 6 of the report.

- Is it reasonably necessary to implement or interpret an act of the General Assembly or of Congress or of a regulation of a federal agency?
- Was it adopted in accordance with G.S. 105-262.1?

The act changes the fiscal note requirement for rulemaking to allow the Department to prepare its own fiscal note. It will not need to submit the fiscal note to the Office of State Budget and Management. The fiscal note must be submitted with the proposed rule to the Codifier of Rules and posted on the Internet. A person may comment on the fiscal note in the same manner a person may comment on a proposed rule. Section 4 of the act provides that the Department does not need to prepare a fiscal note for a proposed rule submitted to the Codifier of Rules prior to December 31, 2012. The reason for this waiver is that any rule submitted before the end of this calendar year under the statute created by this act is limited to the Department's application of G.S. 105-130.5A. The subject of the rule has been debated in the General Assembly during the 2011 session, where the Fiscal Research Division prepared a fiscal memo, and it has been the subject of four Revenue Laws Study Committee meetings in 2011 and 2012. The fiscal issues surrounding this particular rule appear to be well-known and understood by all the parties.

The act exempts rules proposed by the Department from the delayed effective date provisions that apply whenever the RRC receives 10 or more objections to a rule requesting review by the legislature. A rule adopted under this expedited process becomes effective on the last day of the month the Codifier of Rules enters the rule in the Code. This effective date provision differs from the general effective date provision in Chapter 150B and enables the rule to become effective a month earlier. Section 6 of the act clarifies that the Secretary's authority under G.S. 105-130.5A exists continuously for taxable years beginning on or after January 1, 2012. After a rule becomes effective, the Secretary may issue a proposed denial of a refund or a proposed assessment under the authority of G.S. 105-130.5A for any taxable year that beginning on or after January 1, 2012.

The act only applies to G.S. 105-130.5A. It does not apply to the Secretary's interpretations of the repealed statutes that continue to be applicable for taxable years beginning before January 1, 2012: G.S. 105-130.6, 105-130.15, and 105-130.16. The Department has issued a directive offering guidance on its interpretation of those laws, CD-12-01, and the directive appears to set forth the Department's application of the law as upheld by the North Carolina Courts. The Department has also issued a directive offering guidance on its interpretation of the newly enacted law, G.S. 105-130.5A, in CD-12-02. Section 5 of the act provides that a taxpayer who relied upon the interpretation in that Directive and whose North Carolina taxable income for the 2012 taxable year is less under the Directive's interpretation than under an interpretation adopted through the rulemaking process may rely on the interpretation under the Directive for the 2012 taxable year.

Appraisal Mgmt Co Reported to Dept of Revenue.

Session Law	*Bill #*	*Sponsor*
S.L. 2012-65	**HB 1028**	**Rep. Howard, Starnes**

AN ACT TO REQUIRE THE NORTH CAROLINA APPRAISAL BOARD TO REPORT THE RECORDS OF APPRAISAL MANAGEMENT COMPANIES TO THE NORTH CAROLINA DEPARTMENT OF REVENUE.

OVERVIEW: This act requires the North Carolina Appraisal Board to report annually to the North Carolina Department of Revenue the following information about registered appraisal management companies: name; address; process agent, if any; type of entity; employer identification number or social security number; and North Carolina Secretary of State identification number, if any. The legislation was a recommendation of the Revenue Laws Study Committee.

FISCAL IMPACT: This act has no fiscal impact.

EFFECTIVE DATE: This act became effective when the Governor signed it into law on June 26, 2012.

ANALYSIS: The North Carolina Appraisal Board regulates real estate appraisal management companies, which are defined as entities that use a network of licensed appraisers who are independent contractors to perform appraisals. Federal regulations adopted in response to the housing crisis led to the growth of appraisal management companies. The appraisal management companies are intended to increase the quality and reliability of appraisals to prevent another housing crisis. The State began requiring appraisal management companies to register with the Appraisal Board in January 2011.[160] The Board has approximately 140 registered appraisal management companies. Only six of the 140 are North Carolina companies.

Although the out-of-state companies owe State income tax on the appraisal work conducted within the State, the Revenue Laws Study Committee questioned whether the companies were reporting the income and paying the tax. The purpose of the act is to insure out-of-state appraisal management companies are complying with North Carolina tax law. This act requires the Appraisal Board to report annually to the Department of Revenue information collected from appraisal management companies during a registration process. All of the information this act requires the Appraisal Board to report is already disclosed when an appraisal management company registers. The Department of Revenue will be able to use the information from the Appraisal Board to check the filing status of registered appraisal management companies.

RTP District Amendments.

Session Law	*Bill #*	*Sponsor*
S.L. 2012-73	**HB 391**	**Rep. Avila, Torbett**

AN ACT TO REVISE THE LAWS RELATING TO COUNTY RESEARCH AND PRODUCTION SERVICE DISTRICTS TO REFLECT CHANGED CIRCUMSTANCES, TO ALLOW FLEXIBILITY IN PROVISION OF SERVICES IN URBAN AREAS OF SUCH DISTRICTS, AND TO AMEND THE COUNTY SERVICE DISTRICT ACT OF 1973 RELATING TO APPROVAL OF PROPERTY TAXES IN MULTIJURISDICTIONAL INDUSTRIAL PARK DISTRICTS.

OVERVIEW: This act amends the authorizing statutes for county research and production districts to allow for additional permitted uses in the districts, including mixed-use development that combines residential, retail, and business use. The act also allows each county in which a multijurisdictional industrial park is located to levy a tax in the portion of the park in that county and increases the property tax limit in multijurisdictional industrial parks.

[160] S.L. 2010-141, Article 2 of Chapter 93E of the General Statutes.

FISCAL IMPACT: This act has no fiscal impact at the State level.

EFFECTIVE DATE: This act became effective when the Governor signed it into law on June 26, 2012.

ANALYSIS: In 1985, the General Assembly authorized counties to establish county research and production districts. Under this authority, a board of commissioners may, by resolution, establish a research and production district for any area of the county if the area meets the statutory standards. Prior to passing a resolution creating the district, the board of county commissioners must publish a report outlining the district and hold a public hearing on the formation of the district. Multi-county districts are also authorized. For multi-county districts, the boards of county commissioners may pass concurrent resolutions. A county may levy property taxes within the district in addition to those levied throughout the county with a cap of 10¢ on each $100 value of taxable property.

The original standards for a research and production service district limited real property in the district to use for research or scientifically-oriented production or for associated commercial or institutional purposes. The original standards also included acreage requirements, employment requirements, and a restriction on the number of permanent residents in the district. The standards also provided that no part of a district could be within the boundaries of any incorporated city or town. At the time the county research and production service district legislation was enacted it was assumed that the Research Triangle Park would be the only district created under the act due to the acreage and employment level standards need to qualify for the creation of a district.

In 2009, the General Assembly amended these standards to allow for the creation of a district if all of the real property in the district is part of a multijurisdictional industrial park.[161] The maximum property tax rate for a district in a multijurisdictional industrial park is 15¢ on each $100 value of taxable property. Currently, there is one multijurisdictional industrial park, Triangle North, located in Franklin, Granville, Vance, and Warren Counties.

This act broadens the permitted uses in county research and production districts to allow for mixed-use development that combines residential, retail, and business use. The expansion of the permitted uses was requested by the Research Triangle Foundation. The Foundation sought to expand the purposes in county research and production service district to adapt to changing business models and remain competitive in attracting new tenants.

Specifically, real property in a district may be used for the following additional purposes:

- Scientifically-oriented technology and education.
- Residential purposes associated with scientifically-oriented production, technology, or education.
- Any other purpose specifically authorized in the covenants adopted to restrict the use of the real property.

To finance the increase in services that must be provided in areas with residential development, the act also authorizes a board of county commissioners (board) to establish urban research service districts (URSD) within existing county research and production districts. The method of formation and governance of URSDs are substantially similar to provisions for county research and production service districts.

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[161] S.L. 2009-523.

A URSD must be wholly located within a county research and production service district, must be wholly located within the county that establishes the URSD, and may not be contained in any other URSD. Prior to establishing a URSD, the board must receive a petition requesting creation of the URSD from 50% of the owners of real property in the proposed URSD that own at least 50% of the total area of the real property in the proposed URSD.

The board must provide an advisory committee for each URSD. The advisory committee will consist of owners and tenants of the URSD, an appointee of the developer of the district in which the URSD is located, and appointees of the board. The committee will advise the board on the services, facilities, and functions of the URSD.

To extend an URSD, the board must find the following: (1) the covenants restricting the use of real property will apply to the extension area; (2) 100% of the owners of real property in the extension area request to be added to the URSD; (3) the extension area is contiguous to the URSD; and (4) the extension area requires the additional services, facilities, or functions served by the USRD.

To remove area from an USRD, the Board must find the following: (1) the removal is recommended by a vote of two-thirds of the owners and tenants association and requested by 100% of property owners in the area to be removed; (2) the area to be removed no longer requires the additional services, facilities, or functions served by the USRD; and (3) the county has not financed any project for which taxes are levied on the area.

The board must provide services for which the URSD is being taxed in a reasonable time. The board may also authorize the developer of the county research and production service district in which the URSD is located to contract with any local government for services within the URSD.

The board may levy taxes in the URSD to finance and maintain services within the URSD. The taxes levied in the URSD are in addition to the taxes levied at the county level and the taxes levied in the research and development district. The rate of the tax in the URSD may not exceed the rate levied in the city with the largest population that is 1) contiguous to the county research and production service district in which the URSD is located, and 2) located primarily with in the same county as the URSD.[162] The taxes levied may be used for services in the URSD and debt service for debt incurred by the county for capital projects in the URSD.

This act also allows each county in which a multijurisdictional industrial park is located to determine whether or not to levy a tax in the portion of the park in that county. This change was requested by the existing multijurisdictional industrial park, Triangle North. Unlike Research Triangle Park, Triangle North does not consist of one contiguous tract of land. Due to the separation of the tracts, each county with a portion of the park in its jurisdiction requested the flexibility to levy taxes appropriate to the level of service required in the portion of the park in that county. The act also increases the property tax limit in multijurisdictional industrial parks from 15¢ on each $100 value of taxable property to 20¢ on each $100 value of taxable property.

[162] There are three cities contiguous to RTP that could potentially meet this definition: Cary (tax rate of 33¢ per $100 value of taxable property); Durham (tax rate 55¢ per $100 value of taxable property); and Morrisville (tax rate 36¢ per $100 value of taxable property).

Economic Devpt. & Finance Changes.

Session Law	*Bill #*	*Sponsor*
S.L. 2012-74	**HB 1015**	**Rep. Howard, Starnes**

AN ACT TO SET THE REGULATORY FEES AND TO ENHANCE ECONOMIC DEVELOPMENT.

OVERVIEW: This act does the following:

- Sets the rates for the public utility regulatory fees and the insurance regulatory charge for FY12-13 that are necessary to fund the Public Utilities Commission and the Department of Insurance. The rates for this year are the same as the rates for the prior fiscal year. The utility regulatory rates are expected to generate $14.2 million, and they became effective July 1, 2012. The insurance regulatory charge is expected to generate $29.98 million, and it became effective when the Governor signed it into law on June 26, 2012.
- Creates an individual income tax deduction for educator expenses to ensure that North Carolina educators will continue to receive the same tax benefit they have received since 2002, regardless of whether Congress extends the federal educator expense deduction. The deduction will reduce General Fund revenue by $1.8 million for FY 2012-13. The provision is effective for taxable years beginning on or after January 1, 2012.
- Clarifies and extends the time to apply for a sales tax refund of aviation fuel for FY 2010-11 and FY 2011-12. The refund will reduce General Fund revenues by $3.15 million for FY 2012-13 and it will reduce local government revenues by $2.72 million.[163] The provision became effective when the Governor signed it into law on June 26, 2012.
- Permits the use of Industrial Development Fund moneys for sewer infrastructure projects in adjoining counties. This provision has no General Fund impact; the IDF does not receive General Fund appropriations, it is funded by loan repayments only. The provision became effective when the Governor signed it into law on June 26, 2012.
- Temporarily allows a 20-year carryforward period under Article 3J for a taxpayer who makes an investment of $100 million in a tier one county. The change may decrease General Fund revenues by $2.4 million over the 20-year lifetime of the credit. The temporary change is effective for taxable years beginning on or after January 1, 2012, and expires for taxable years beginning on or after January 1, 2013.
- Makes a technical correction to the definition of a port enhancement zone. This change has no fiscal impact. The correction becomes effective for taxable years beginning on or after January 1, 2013; this effective date is the same effective date applicable to the 2011 legislation that this provision clarifies.
- Accelerates the sales tax relief enacted in 2011 for purchases of specialized equipment used at State ports by providing a one-year sales tax refund for these purchases made in FY 2012-13. This provision is expected to decrease General Fund revenues by

[163] The local government revenue loss would be felt primarily in Forsyth and Mecklenburg Counties.

$58,000 to $64,000 in FY 2013-14. The provision became effective when the Governor signed it into law on June 26, 2012.

FISCAL IMPACT: The fiscal impact of the changes is included in the Overview. *(For a more complete fiscal analysis, see Finance Committee Highlights, 2012 Session, available online at www.ncleg.net.)*

EFFECTIVE DATE: The effective date of the changes is included in the Overview.

ANALYSIS: The act makes several changes necessary to balance the FY 2012-13 budget, enhance economic development projects, and clarify existing economic development statutes.

Set Regulatory Fees

In 1989, the General Assembly made a policy decision to finance the costs of the Utilities Commission and Public Staff through the imposition of a regulatory fee imposed on the entities regulated by the Commission. The General Assembly made a similar policy decision in 1991 to defray the State's cost of regulating the insurance industry through a regulatory charge imposed as a percentage of each insurance company's gross premiums tax liability. The General Assembly sets the rates for each fiscal year as provided in the statutes. The rates may not exceed the amount necessary to generate funds sufficient to defray the estimated cost of operating these agencies for the upcoming fiscal year, including a reasonable margin for a reserve fund. The revenues generated are credited to an interest-bearing, nonreverting special revenue fund and may only be expended upon appropriation of the General Assembly.[164] Section 1 sets the rates for FY 2012-13; the rates are the same as the rates for the prior fiscal year.

Regulatory Fee for Utilities Commission. – Subsection (a) sets the rate for the public utility regulatory fee for FY 2012-13 at 0.12%.[165] The rate has not changed since FY 2004-05. The utility regulatory fee is a tax that was first imposed in 1989. The proceeds of the fee are credited to the Utilities Commission and Public Staff Fund and used to defray the State's cost in regulating public utilities. The regulatory fee is imposed on all utilities that are subject to regulation by the North Carolina Utilities Commission. The fee is a percentage of the utility's North Carolina jurisdictional revenues. In general, jurisdictional revenue is derived from providing utility service in North Carolina.

Regulatory Fee for Electric Membership Corporation. – Subsection (b) sets at $200,000 for FY 2012-13 the annual public utility regulatory fee imposed on electric membership corporations whose principal purpose is to furnish or cause to be furnished bulk electric supplies at wholesale. The rate must be established by the General Assembly each year. The rate has not changed since the General Assembly enacted it in 1999. The proceeds of the fee are credited to the Utilities Commission and Public Staff Fund and used to defray the State's cost in regulating electric membership corporations. The 1999 General Assembly enacted S.L. 1999-180, which authorized electric membership corporations to form subsidiary corporations that may provide energy services and products, telecommunications services and products, and water and wastewater collection and treatment. The subsidiary must fully compensate the electric membership corporation for its use of the corporation's personnel, services, equipment, and property. The Utilities Commission is charged with regulating this aspect of the subsidiary's

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[164] G.S. 58-6-25(d) provides that the money credited to the Insurance Regulatory Fund is used to reimburse the General Fund for the appropriations made for specified purposes.

[165] G.S. 62-302(b) provides that the rate for each fiscal year is the greater of the rate established by the General Assembly or $6.25 each quarter. The General Assembly has always established the rate.

business and, to pay for this regulation, S.L. 1999-180 levied a flat-rate regulatory fee to be paid annually by the North Carolina Electric Membership Corporation.[166] Thus, the fee imposed on the North Carolina Electric Membership Cooperation will be passed on to its member electric membership corporations.

Insurance Regulatory Charge. – Subsection (c) sets the insurance regulatory charge at 6% for the 2012 calendar year, the same as the rate set for the 2011 and 2010 calendar years. The insurance regulatory charge was first enacted in 1991 to defray the State's cost of regulating the insurance industry. The rate of the regulatory charge must be established by the General Assembly. The charge is a percentage of each insurance company's gross premiums tax liability.[167]

Continue Educator Expense Deduction[168]

Section 2 of this act allows an individual income tax deduction for teachers in elementary or secondary education of up to $250 for unreimbursed expenses paid or incurred for school supplies. Congress enacted a tax benefit to help K-12 teaches defray some of the expenditures they voluntarily make to enhance the quality of their students' education. The deduction has been available for tax years 2002-2011. Since North Carolina begins its calculation of taxable income with federal AGI, teachers in North Carolina have been allowed the deduction at the State level as well.

Congress has not extended the tax deduction beyond the 2011 taxable year. This section allows North Carolina teachers to continue deducting up to $250 for unreimbursed expenses paid or incurred for school supplies for taxable years beginning on or after January 1, 2012. If a taxpayer files a joint return and both spouses are eligible educators, then they both may claim up to $250 of expenses for a $500 total on a joint return. If Congress extends the federal tax deduction beyond taxable year 2011, then this provision will not be needed. However, if it does not, this provision ensures that North Carolina educators will continue to receive the same tax benefit they have received since 2002.

Clarify and Extend the Time to Apply for a Sales Tax Refund of Aviation Fuel[169]

Since 2005, an interstate passenger air carrier has been allowed an annual refund of the sales and use tax paid by it on fuel in excess of $2,500,000. The only taxpayer that currently qualifies for this credit is U.S. Airways. Section 3 of the act ensures that the taxpayer may receive the refund for purchases made between January 1, 2010, and June 30, 2011.

To receive the refund, a taxpayer must apply for it; a refund applied for after the due date is barred. Prior to 2010, the refund period covered purchases made during a calendar year, and the refund application was due within six months after the end of the calendar year. In 2010, the General Assembly enacted legislation, S.L. 2010-166, that consolidated and made uniform sunset and reporting features and requirements across the State's various economic incentives. Among the changes, the due dates of the sales tax refunds were standardized to apply to a

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[166] The North Carolina Electric Membership Corporation is the only electric membership corporation whose principal purpose is to furnish or cause to be furnished bulk electric supplies at wholesale as provided in G.S. 117-16. It is a "generation and supply cooperative" owned by its members. Its members are all but one of the existing North Carolina electric membership corporations, which are "distribution cooperatives."

[167] Medical service corporations and health maintenance organizations began paying the charge in 2000.

[168] This provision was included in Senate Bill 795 and House Bill 950, v.4.

[169] This provision was included in House Bill 142.

fiscal year. The effective date of the legislation specifically provided that, "The first claim for refund by a taxpayer whose sales tax refund period is changed by this act is due within six months after July 1, 2010, and applies to purchases during the time period not covered by the taxpayer's last claim for refund."

There was some confusion associated with the 2010 legislation. During the same session, there was another bill,[170] which passed first, extending various sunsets from January 1, 2011, to January 1, 2013. S.L. 2010-166 failed to take into account the extension of the sunsets enacted by the other bill. When S.L. 2010-166 was enacted, it unintentionally nullified the sunset extensions because it was enacted after the first one passed. This error was later corrected in 2011 technical corrections legislation.[171]

In the midst of the confusion, the transition from filing for a refund on a calendar year basis to a fiscal year basis, which should have occurred in 2010, was overlooked by both U.S. Airways and the Department of Revenue. In February of 2011, U.S. Airways filed for a refund for calendar year 2010 and received it. In January of 2012, U.S. Airways filed for a refund for calendar year 2011 but was told that the claim for the first six months of 2011 was barred due to an untimely application, and the refund request for the second six months of 2011 was not yet due.

Section 3 of this act does two things. First, it validates the 2010 refund application and payment issued by the Department of Revenue and second, it provides for the transition from a calendar year refund period to a fiscal year refund period. Subsection (a) validates the 2010 refund payment made on a calendar year basis; this subsection became effective when the act became law on June 26, 2012. Subsection (b) allows the taxpayer to apply for a sales tax refund for aviation fuel purchased by it in excess of $1,250,000 between January 1, 2011, and June 30, 2011, so long as the application is made before October 1, 2012. The State refund amount is capped at $3,150,000. The cap is reduced to reflect the fact that the refund would only be for a six-month period. Without the cap, the taxpayer would have been entitled to a State sales tax refund amount of $6,340,000.[172] The provision has a fiscal impact because the taxpayer is not entitled to the refund under current law since it filed an untimely application. This subsection became effective January 1, 2011, and applies to purchases made on or after that date.

Industrial Development Fund Changes[173]

The Industrial Development Fund (IDF)[174] provides funds to assist economically distressed counties[175] and cities located in those counties with creating new jobs. The funds must be used

[170] S.L. 2010-31.
[171] S.L. 2011-330.
[172] The taxpayer will also receive a local sales tax refund amount of $2.71 million.
[173] This provision was included in House Bill 142.
[174] IDF is currently funded by loan repayments only; there is no longer a General Fund appropriation for IDF. Loan repayments average around $50,000 annually. The fund is within the Department of Commerce.
[175] "Economically distressed county" is defined as a county that has one of the 65 highest rankings under the development tier designation. Under the development tier designation, the 40 most distressed counties are designated as tier 1, the next 40 as tier 2 and the 20 least distressed as tier 3.

for an infrastructure project[176] located on the site of an eligible industry[177] or, if not located on the site, must be directly related to the operation of the specific eligible industrial activity. The funds must be expended at a maximum rate of $10,000 per new job created up to a maximum of $500,000 per project.

Section 4 of the act allows the IDF funds to be used by an economically distressed county for a sewer infrastructure project even though the project is located in an adjacent county that is not economically distressed. The act does not change the requirement that the infrastructure project must be directly related to the operation of an eligible industrial activity located in an economically distressed county. This change helps facilitate an economic development project in Davie County. Ashley Furniture is currently upfitting an existing building in Davie County that requires additional sewer capacity. Forsyth County operates the water and sewer system that serves Davie County. While Davie County is an economically distressed county, Forsyth County is not. As applied to this project, the change made by this act enables IDF funds to be used to improve sewer infrastructure located in a county that is not economically distressed to the extent the improvement is directly related to the operation of an eligible industrial activity in an economically distressed county. Forsyth County has indicated that the improvements to the sewer system for purposes of serving the Ashley Furniture site will not enhance sewer service in Forsyth County.

Temporary Expansion of 20-Year Carryforward Provision under Article 3J

Article 3J[178] of the tax statutes provides a tax credit for making an investment in business property that the taxpayer places in service in connection with an eligible business during the taxable year.[179] The investment must exceed a minimum threshold amount; the threshold amount varies based upon a county's tier designation from $0 for a tier one county to $2 million for a tier three county. Any unused portion of the credit may be carried forward for the succeeding five years.[180] If the Secretary of Commerce makes a written determination that a taxpayer is expected to invest at least $150 million worth of business and real property in a two-year period, then the carryforward period of any unused portion of a credit is extended to 20 years.

Section 5 of the act provides a temporary, one-year expansion of the 20-year carryforward provision. To be eligible for the 20-year carryforward, a taxpayer must receive a written determination from the Secretary of Commerce during the 2012 taxable year that the taxpayer is expected to purchase or lease, and place into service in connection with an eligible business, at least $100 million worth of business and real property. The investment must be made within a two-year period, and it must be made in a tier one county. If the taxpayer fails to make the necessary investment within the two-year period, the expanded carryforward

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[176] The IDF funds must be used for (i) installation of or purchases of equipment for eligible industries; (ii) structural repairs and renovations of buildings for expansion of eligible industries; or (iii) construction of or improvements to new or existing utility lines or equipment or transportation infrastructure for existing or new building for the eligible industries.

[177] An eligible industry is defined as a company or person engaged in the business of air courier services, information technology and services, manufacturing, or warehousing and wholesale trade.

[178] North Carolina seeks to incent businesses to create jobs and invest in business property primarily through Article 3J tax credits. A taxpayer's eligibility for a credit and the amount of the credit varies depending upon the county or zone in which the jobs are created or the investments are made. These credits may be combined to offset up to 50% of the taxpayer's State income and franchise tax liability, and as a general rule, unused credits may be carried forward for up to five years.

[179] G.S. 105-129.88.

[180] G.S. 105-129.84(c).

provision will not apply. There is at least one potential project that may benefit from this change; this project is expected to be located in Halifax County.

Port Enhancement Zone Technical Correction

Under Article 3J of the tax statutes enhanced incentives are available to tier 1 counties. Those same enhanced incentives are available to a taxpayer located in an urban progress zone (UP zone) or an agrarian growth zone (AG zone). Last year, in S.L. 2011-302, the General Assembly created a new type of zone eligible for enhanced credits under Article 3J known as a "port enhancement zone."[181] The enhanced incentives for a port enhancement zone become effective for taxable years beginning on or after January 1, 2013. Section 6 of the act makes a change to the conditions that create a port enhancement zone in order to cover the areas the original legislation intended to include.

A port enhancement zone is an area that meets the following conditions:

- Is comprised of one or more contiguous census tracts, census block groups, or both, in the most recent federal census.
- All of the area is located within 25 miles of a state port and is capable of being used to enhance port operations.
- Every census tract and census block group in the area has at least 11% of households with incomes of $15,000 or less.
- The area of the county that is included in one or more port enhancement zones may not exceed 5% of the total area of the county.

The act changes the conditions to say that the zone may be comprised of <u>*part or all*</u> of one or more contiguous census tracts, census block groups, or both, in the most recent federal decennial census. Without this language, the areas intended to be covered by this provision would not meet the definition because the relevant tract exceeds the 5% limitation. This change would also make the port enhancement zone definition consistent with the UP zone definition.

North Carolina has two State ports, the Port of Morehead City and the Port of Wilmington. The Port of Morehead City is located in Carteret County; Carteret County is a tier 3 county. The Port of Wilmington is located in New Hanover County; New Hanover County is also a tier 3 county.

One-Year Sales Tax Refund for Purchases of Specialized Equipment used at State Ports

Last session, the General Assembly expanded the 1%, $80 preferential tax rate to include specialized equipment used at a port facility to unload or process bulk cargo to make it suitable

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[181] The enhanced credits available to an UP zone, an AG zone, and a ports enhancement zone under Article 3J are as follows:

- Jobs tax credit. – The threshold for new full-time jobs created to qualify for the tax credit for creating new jobs is the same as for a tier 1 county, five ; and the amount of the credit is increased by $1,000 per job. If the job is filled by a resident of the zone or a long-term unemployed worker, the credit is increased by an additional $2,000 per job.
- Machinery and equipment investment tax credit. – The investment threshold requirement to qualify for the tax credit for investing in business property is the same as a tier 1 county, which is none. The amount of the investment tax credit is also the same as a tier 1 county, 7% of the cost of tangible personal property that is placed in service during the taxable year.

for delivery to and for use by manufacturing facilities.[182] The change in the law becomes effective July 1, 2013; the reason for the out-year effective date was to ensure the provision did not impact the current fiscal biennium. At the time the legislation was enacted, there were no known projects that would benefit from the preferential tax rate. Today, it appears there is at least one taxpayer considering a project at the one of the State ports that would benefit from the preferential tax rate. To advance the benefit of the incentive, without impacting the current fiscal biennium, Section 7 of the act provides a full refund of local sales taxes and a portion of State taxes for purchases of specialized equipment used at a port facility made between July 1, 2012, and June 30, 2013. The portion of State taxes refunded is equal to the amount of tax paid less the amount of tax the facility would have paid had it been subject to tax under Article 5F. The taxpayer must make a written request for a refund on or after July 1, 2013, and before January 1, 2014. Although the refund provision applies to purchases made during this fiscal biennium, it is not payable until FY 2013-14, thus ensuring that the provision does not impact the current fiscal biennium.

Explanation
PART I: TECHNICAL CHANGES
A taxpayer is allowed a deduction for the amount by which the basis of a depreciable asset is required to be reduced under the Code for federal tax purposes because of a *tax credit* allowed against the corporation's federal taxable income. Section 1603 of ARRTA[183] directs the Treasury to provide cash payments, or grants, to eligible persons who place in service specified energy property and apply for the payments. The purpose of section 1603 is to reimburse eligible applicants for a portion of the expense of such property. A section 1603 grant recipient is required to reduce the basis of the asset. This section allows a taxpayer to reduce his or her State taxable income if the taxpayer receives a section 1603 *grant payment* rather than a credit under sections 45 or 48 of the Code.
This section deletes the word "adjusted" as used in the definition of North Carolina taxable income for nonresidents and part-year residents. In 2011, the General Assembly changed the starting point for calculating NC taxable income from federal taxable income to federal adjusted gross income.[184] This change simplified the calculation of NC taxable income because taxpayers no longer have to make adjustments to reduce the federal standard deduction and exemption amounts to determine the State deduction and exemption amounts. The intent was not to change the end result or impact the amount of NC taxable income. For purposes of prorating NC taxable income for nonresidents and part-year residents, the relevant fraction should only refer to "gross income," which was how the proration was computed prior to the 2011 change. Using "adjusted gross income" could produce a different result, changing the amount of NC taxable income, which was not the intent of the 2011 change.

[182] S.L. 2011-302.
[183] The American Recovery and Reinvestment Tax Act of 2009 (P.L. 111-5).
[184] Section 31A.1 of S.L. 2011-145.

This section clarifies that the standard deduction amount for individual income tax purposes is the *lesser* of the amount set out in the statute or the amount allowed under the Code. The current law refers only to the "standard deduction amount listed in the table below." However, there are instances where the North Carolina standard deduction is zero[185] or less than is shown in the table. This is another technical change identified by the Department as the result of the passage of Section 31A.1 of S.L. 2011-145.
This section makes changes to the sales and use tax exemption statute with regard to motor fuels and installation and delivery charges. Motor fuels are subject either to the motor fuels tax or to the sales tax, but not both. Dyed diesel and dyed kerosene are examples of motor fuels that are subject to the sales tax, but are nevertheless defined as motor fuels. This change in the sales tax exemption statute makes it clear that, to the extent a motor fuel is taxed under Article 36C (Gasoline, Diesel, and Blends), it is exempt from sales and use tax. This section also amends the sales tax exemptions for delivery and installation charges so that the language is parallel. It adds the phrase "similar billing document," which currently appears in the exemption for delivery charges, to the exemption for installation charges. It adds the phrase "at the time of sale," which currently appears in the exemption for installation charges, to the exemption for delivery charges.
This section removes the words "manufacturing fuel" from the heading of Article 5F of Chapter 105 because the tax on manufacturing fuel was repealed, effective July 1, 2010.
This section corrects the catchline for G.S. 105-187.70 because it refers to an Article that does not exist.
This section updates from January 1, 2011, to January 1, 2012, the reference to the Internal Revenue Code. This change keeps the statute up to date, but does not result in any substantive changes because there have not been any federal tax law changes since January 1, 2011, that impact the calculation of North Carolina taxable income.
This section adds an additional Code reference to the statute that governs when a return, report, payment, or any other document that is mailed to the Department is timely filed. Code section 7503 addresses when the due date falls on a Saturday, Sunday, or a holiday.
This section corrects a statutory reference.
This section conforms the statute on the scope of the local use tax so that it is consistent with the parallel statute for the State use tax, which was amended during the 2011 session. The 2011 change[186] was a clarifying change.
S.L. 2011-72 authorized certain cities to establish a municipal service district for the purpose of converting private residential streets to public streets. The act was designed to address 14 residential developments in the Town of Morrisville that were seeking to convert private streets to public streets. After the bill passed, it was discovered that some of the developments were created under the Condominium Act rather than the Planned

[185] If a taxpayer is (1) married filing a separate return for federal income tax purposes and the taxpayer's spouse itemizes deductions; (2) a nonresident alien; or (3) filing a short-year return because of a change in the taxpayer's accounting period, the taxpayer is not entitled to the standard deduction.
[186] S.L. 2011-330, s. 25(a).

Development Act, which the bill amended. This section makes the necessary conforming changes.
This section corrects several errors in the 2011 special license plate act.[187] It adds the "Mountains-to-Sea Trail" plate to the list of plates that may be on a background other than the First in Flight background, which was the original intent. Under current law, the authorization for the plate states that it "shall bear the phrase 'Mountains-to-Sea Trail' with a background designed by the Friends of the Mountains-to-Sea Trail," suggesting that the organization may design its own background. However, in order for an organization to have a background other than First in Flight, it must be authorized in G.S. 20-63. This section also corrects errors with regard to the fees for the Sustainable Fisheries and the Morgan Horse Club plates.
This section allows a taxpayer to claim an Article 3J credit that the taxpayer would have been ineligible for prior to 2010 because it failed to meet the environmental impact standard, which was loosened retroactively that year. In 2010, the General Assembly changed the environmental standard for Article 3J retroactively to 2007.[188] By loosening the standard and making the change retroactive to 2007, the General Assembly intended to allow certain taxpayers to file for an Article 3J credit. However, the 2010 change failed to make a corresponding change to the statute of limitations, which requires claims to be filed within six months of the due date of the return. Therefore, a taxpayer who did not claim the credit when the original standard was in effect would be unable to take advantage of the retroactive change which loosened the standard. This change does not have a fiscal impact.
This section makes changes required by the fact that G.S. 105-130.6, which dealt with forced combinations, was repealed last year and replaced with a new statute. The

[187] S.L. 2011-392.

[188] Sec. 1.3 of S.L. 2010-147 (*Various Economic Incentives*). Prior to the 2010 change, a taxpayer was eligible for certain economic incentives if the taxpayer had no pending administrative, civil, or criminal enforcement actions based on alleged *significant* violations of any DENR-implemented programs and had no final determination of responsibility for any *significant* administrative, civil, or criminal violation of any DENR-implemented program within the prior five years. Article 3J had a definition of what constituted a "significant violation" but there was some confusion as to whether certain violations met the definition. At the time, the Department made no distinction between civil and criminal violations or on the basis of whether the violation was knowing and willful. The 2010 clarification was designed to ensure that minor violations do not disqualify a taxpayer that would otherwise be eligible for a tax incentive. The current definition of an "environmental disqualifying event," as enacted by S.L. 2010-147, is as follows:

(9a) Environmental disqualifying event. – Any of the following occurrences:

a. During the tax year in which the activity occurred for which a credit is being claimed, a civil penalty was assessed against the taxpayer by the Department of Environment and Natural Resources for failure to comply with an order issued by an agency of the Department to abate or remediate a violation of any program administered by the agency.

b. During the tax year in which the activity occurred for which a credit is being claimed or in the prior two tax years, any of the following:

1. A finding was made by the Department of Environment and Natural Resources that the taxpayer knowingly and willfully, as defined in G.S. 143-215.6B, including all limitations thereto, committed a violation of any program implemented by an agency of the Department.

definitions are the same definitions that were in G.S. 105-130.6, except for "parent," which was not defined.
PART II: CLARIFYING AND ADMINISTRATIVE CHANGES
This section allows a wholesale or retail dealer of other tobacco products to provide security to the Secretary in the form of an irrevocable letter of credit as an alternative to a bond. An irrevocable letter of credit is typically used by a foreign company that is unable to obtain a bond because it does not have assets in this country. This form of security is consistent with what is currently allowed under the motor fuels tax statutes.
S.L. 2011-12 added synthetic cannabinoids to the list of controlled substances. No corresponding changes were made to the unauthorized substance tax laws. Therefore, without this change, they would be grouped with "other controlled substances" and be subject to tax at a rate of $200 per gram. However, synthetic cannabinoids are most analogous to marijuana, which is taxed at $3.50 per gram. This section taxes synthetic cannabinoids at the same rate as marijuana, effective when the S.L. 2011-12 became law.
Holding companies are subject to an annual franchise tax, which is capped at $75,000. A holding company is currently defined as one that receives more than 80% of its gross income from corporations in which it owns, directly or indirectly, more than 50% of the outstanding voting stock or capital interests. However, a corporation whose only asset is an investment in subsidiaries and has no income cannot meet the 80% test because the denominator would be zero. This section expands the definition of a holding company to address this situation. The Department has indicated that this is a clarifying change, not a substantive one. A question has arisen about this specific fact pattern where a taxpayer is clearly a holding company, in that all of its assets are investments in subsidiaries. For the year in question, the holding company had no income. Therefore, there would be $0 in income from subsidiaries and $0 in total income. Under a strict application of G.S. 105-120.2, $0 divided by $0 would result in an undefined mathematical value. Because it is undefined, it cannot be determined if it exceeds 80%. Alternatively, if one of the subsidiaries of the holding company had issued a dividend of as little as one cent, then 100% of the income would be coming from investments in subsidiaries. The Department believes that this interpretation is not what the General Assembly intended. The Department's interpretation is that it was a holding company and subject to the cap of $75,000 on franchise tax.

2. An assessment for damages to fish or wildlife pursuant to G.S. 143-215.3(a)(7) was made against the taxpayer
3. A judicial order for injunctive relief was issued against the taxpayer in connection with a violation of any program implemented by an agency of the Department of Environment and Natural Resources.

c. During the tax year in which the activity occurred for which the credit is being claimed or in the prior four tax years, a criminal penalty was imposed on the taxpayer in connection with a violation of any program implemented by an agency of the Department of Environment and Natural Resources.

This section makes the definition of business property in Article 3J consistent with the definition of business property in Article 3B[189] and the old provisions for eligible machinery and equipment in Article 3A.[190]
This section provides that a taxpayer may qualify for innocent spouse relief at the State level if the taxpayer would have qualified for relief at the federal level even if the taxpayer does not have a federal tax liability. North Carolina follows federal law with regard to a taxpayer's eligibility for innocent spouse relief. Prior to this change, a taxpayer would have had to have a federal tax liability that he or she was relieved of in order to qualify for relief at the State level. With this change, if the taxpayer would have qualified for innocent spouse relief had the taxpayer had a federal tax liability, the taxpayer is eligible for relief at the State level.
This section adds the education expenses credit to the list of credits that are not allowed to be claimed by an estate or trust. In 2011, the General Assembly enacted the Tax Credit for Children with Disabilities.[191] This is a conforming change that should have been made at the time and is consistent with the other credits that are not eligible to be claimed by an estate.
This section makes three changes to sales tax definitions in order to conform them to the definitions in the Streamlined Sales and Use Tax Agreement, and it updates the reference to the most current version of the Agreement dated December 19, 2011.
This section clarifies the general sourcing provisions to conform to the requirements in the Streamlined Sales and Use Tax Agreement. It was noted during the 2011 Annual Compliance Review that the existing statute was not consistent with the Streamlined requirements.
This section restores language stating that sales tax must be stated and charged separately that was inadvertently stricken from the statute.[192]
This section restores language relating to the application of use tax to items given away by merchants, which was inadvertently deleted in a 2009 budget provision. The language was originally added to the definition of "sale or selling" in 1996 as the result of a court case.[193]

[189] G.S. 105-129.15(1).
[190] G.S. 105-129.9(a).
[191] S.L. 2011-395. The credit allows an individual income tax credit for up to $3,000 per semester for tuition and special education and related services expenses for a taxpayer's eligible dependent child with a disability who is enrolled in a nonpublic school or a public school where tuition is charged for the eligible dependent child's enrollment.
[192] S.L. 2009-451, s. 27A.3(j).
[193]The use tax, first enacted in 1939, is the complement to the sales tax and applies to the storage, use, or consumption in this State of tangible personal property. Use tax accounts for approximately 5% of total sales and use tax collections. A merchant is liable for use tax on property it *uses* in its business, such as furniture, equipment, décor, or promotional giveaways. Items *sold* by the merchant, however, are not subject to use tax because sales tax will apply when the items are sold at retail. With regard to items given away free of charge, the general rule in this State, and virtually all states, is that a retailer is liable for sales and use tax on those items. Until 1993, the following items were considered used, not sold, and thus subject to use tax: meals provided free to a merchant's employees, food given away to the merchant's patrons, and matches given away to patrons, other than matches given away along with the sale of cigarettes. A group of restaurants appealed the assessment of the tax, claiming that the items should be considered sold. In *Matter of Rock-Ola Café*, 111 N.C.App. 683 (1993), the North Carolina

The language was intended to restrict the application of that case, a broad application of which could be interpreted in such a way so as to eliminate the use tax. In 1996, the Revenue Laws Study Committee recommended limiting the application of the decision to the facts of that case, which involved food given away by restaurants.

In 2009, a number of sales tax statutes were amended to address digital property. While amending those statutes, a number of stylistic and technical changes were also made. The language dealing with items given away by merchants was removed with the intent that it be located elsewhere in the sales and use tax statutes as a technical change. However, it was never relocated. This section restores the language by placing it in a new statutory section, effective the date that the 2009 deletion became effective since there was no intent to remove it.

This section makes two changes related to sales tax refunds for interstate carriers. First, it modifies the reference to "them" to make it clear that, for purposes of calculating a refund on certain cars, parts, fuel, and repair parts, an interstate carrier must include all motor vehicles, railroad cars, locomotives, and airplanes that the applicant owns or leases and that are operated both inside and outside the State in the denominator. Second, it clarifies that airplane miles are not in this State if the airplane only flies over North Carolina but does not take off or land in the State.

A direct pay permit authorizes the holder to purchase property that is subject to sales and use tax without paying the tax to the seller. A person who purchases an item under a direct pay permit is liable for use tax, which is payable when the property is placed in use or the service is received. A person can apply for a direct pay permit if the person purchases an item whose tax status cannot be determined at the time of purchase, and either:

- The place of business where the item will be used is not known at the time of purchase and a different tax consequence applies depending on where the item is used, or
- The manner in which the item will be used is not known at the time of purchase and one or more of the potential uses is taxable but others are not taxable.

Generally speaking, a direct pay permit is not intended to allow purchasers to "shop" for a lower tax rate. It was originally designed to address situations where a purchaser of machinery, for example, did not know at the time of purchase how the machinery was going to be used and, therefore, whether it would be subject to sales tax at the general rate, exempt from tax, or subject to the 1%/$80 rate. In those cases, however, the property was always going to be used in North Carolina. The Department is aware of a situation where a retailer that has purchased items from NC vendors and has taken delivery of those items

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Court of Appeals agreed with the restaurants that these items should be considered sold along with the food the restaurant sold as part of its business. However, the Revenue Laws Study Committee, in its report to the 1996 Regular Session, concluded that the Court's opinion was overly broad in its rationale. The rationale, that the cost of these items is recovered by the sales of other items, taken literally and if applied broadly, could be interpreted to eliminate the use tax altogether in that the cost of all of a merchant's purchases are ultimately covered by the price of sold items. The Committee recommended, and the General Assembly enacted, the language in this section to limit the application of the court's opinion to the facts of that case, which dealt specifically with restaurants. Under this language, property given away by a merchant is exempt from use tax only in the case of restaurants that provide free meals to employees or free bar food to patrons. The bill that was ultimately enacted added language to exempt items of inventory given away to a customer free of charge on the condition that the customer buy similar property ("buy one, get one free").

in NC wants to use a direct pay permit arguing that the items may be shipped out of state at some later date for use in another state. This section adds the words "for storage, use, or consumption in this State" to make it clear that a direct pay permit may not be used to avoid paying NC sales tax in this way. A person who purchases telecommunications service under a direct pay permit must file a return and pay the tax due monthly to the Secretary. This section adds the word "quarterly" so that the filing frequency is consistent with the filing frequency for general State and local sales tax remitters.[194] By providing for quarterly filing, this change conforms the statute to current practice at the Department.
There is an excise tax imposed on piped natural gas received for consumption in this State, which is in lieu of the sales and use tax. The tax is payable on a monthly basis. Under prior law, a taxpayer who was consistently liable for at least $10,000 of tax a month must make a monthly prepayment of the next month's liability. This section changes from $10,000 to $20,000 the prepayment threshold for the tax on piped natural gas, the purpose of which is to be consistent with the prepayment threshold for retailers required to remit sales and use tax.[195] This change does not change the amount of excise tax revenue remitted to the General Fund, but it does change by one month the timing of the payment for the year of the transition to the higher threshold. The Department indicates that it knows of only one company that would be affected by increasing the threshold to $20,000.
Generally speaking, the State may not contract with foreign vendors that refuse to collect use tax, where applicable, on sales delivered to North Carolina. G.S. 143-59.1 requires the Department to periodically provide to the Secretary of Administration a list of ineligible vendors based on this requirement. This section provides that the Department of Administration may not enter into a contract with a vendor if the Department of Revenue has determined that the vendor or an affiliate of the vendor refuses to collect use tax. This language has been agreed to by both the Department of Revenue and the Department of Administration.
This section conforms the statute to current practice at the Department. If a taxpayer files a return electronically, then the taxpayer must pay the tax due before the taxpayer may submit the return.

[194]A taxpayer who is consistently liable for less than $100 a month in State and local sales and use taxes must file a return and pay the taxes due on a quarterly basis. A taxpayer who is consistently liable for at least $100 a month but less than $20,000 a month in State and local sales and use taxes must file a return and pay the taxes due on a monthly basis. (G.S. 105-164.16.)

[195]For sales and use tax, the threshold limit of $10,000 was enacted in 2001 as a means to accelerate the payment of sales and use tax dollars into the General Fund for fiscal year 2001-02. Prior to this change, the threshold amount for making bimonthly payments was $20,000. In the years following 2001, the sales and use tax rate, at its highest, reached 7.75%. The lowering of the threshold amount along with the increase in the tax rate subjected more retailers to the most extensive sales tax remittance requirements. Consequently, many small retailers expressed a cash flow hardship with the pre-payment requirement. In 2010, the General Assembly phased in a restoration of the $20,000 prepayment threshold. The change decreased the number of retailers required to submit a prepayment of 65% of the amount of sales tax revenue to be remitted for the following month.

S.L. 2011-296 changed the fees collected by register of deeds for the purpose of simplifying their collection and remittance. As part of the legislation, a new fee became applicable to the indexing and filing of "subsequent instruments." Several registers of deeds have questioned how to apply the new fee applicable to subsequent instruments that contain references to multiple recorded documents, such as cancellations of multiple deeds of trust or substitution of trustee in multiple documents. This section removes the confusion caused by the new fee applicable to the recording of subsequent instruments by eliminating the fee and imposing a $10 fee for an instrument that assigns more than one security instrument by reference to a previously recorded instrument.
This section makes conforming changes to the statutes dealing with the State Home Foreclosure Prevention Project (SHFPP). The SHFPP was created by the General Assembly in 2008[196] as an emergency program and was expanded and extended in 2010[197] to cover all homeowners. The program is an effort to reduce unnecessary foreclosures providing homeowners with free resources, such as counseling, as they work with servicers to create alternatives to foreclosure. In 2011, the administration and staffing of SHFPP homeowner and counseling activities was transferred to the NC Housing Finance Agency, effective July 1, 2011.[198] Under that legislation, the Office of the Commissioner of Banks retained administration of the pre-foreclosure filings database, servicing invoicing, and the granting of 30-day extensions. This section completes the transfer of all program activities to the NC Housing Finance Agency and removes the program sunset.
This section removes the $5 minimum penalty amount for failure to file a return or failure to pay tax when due, effective January 1, 2014. This change was requested by the Department because TIMS, its new computer system that is not up and running yet, will not be able to compute the minimum penalty well. It will require a work around and likely an addition to the current contract. This has no impact on the General Fund and a negligible impact on the Fines & Forfeiture Fund.
This section provides that the portion of the Register of Deeds fees that are remitted to Cultural Resources for archives and records management shall be placed in a special revenue fund. This change will prevent unspent monies from reverting to the General Fund at the end of a fiscal year, thus ensuring the monies will be used for their intended purpose.
PART III: COMBINED MOTOR VEHICLE REGISTRATION/PROPERTY TAX CHANGES

[196] S.L. 2008-226.
[197] S.L. 2010-168.
[198] S.L. 2011-288.

In 2005, the General Assembly created a framework establishing a combined system for motor vehicle registration renewal and property tax collection. Originally, the act was to become effective the earlier of January 1, 2009, or the date that the Department of Revenue and the Division of Motor Vehicles certified that an integrated computer system is in operation. The effective date has since been extended and is currently set to go into effect July 1, 2013. Under the new system, the taxpayer/motor vehicle owner will receive one bill for property taxes and the DMV license renewal, and DMV will be the collecting authority. Counties will still determine the value and the taxability situs of motor vehicles. A number of conforming changes are needed to fully implement the combined system, which goes into effect July 1, 2013. Part III of this act consists of those changes.
Current law permits the governing body of a taxing unit to pass a resolution directing its tax collector not to collect minimal taxes, defined as up to $5.00, charged on tax records and receipts. This section exempts taxes on registered motor vehicles for two reasons: (1) a minimum of $28 is collected for motor vehicle registration; and (2) DMV, not the counties, will be the collecting authority. Therefore, the minimal tax provision is not applicable with regard to combined motor vehicle and property tax collection.
A taxpayer may appeal motor vehicle taxes on a number of grounds: the valuation by the county, the denial of an application for exemption or exclusion, and on the grounds that the county does not have authority to tax the vehicle because the situs of the vehicle is in another taxing district. The term "taxability" in the appeal statutes has been used to refer to both exemption status and situs, but because there are different time periods that apply depending on the basis of a taxpayer's appeal, the Department recommends separating the statutory provisions.[199] Therefore, this section strikes the term "taxability" from G.S. 105-330.2(b1) so that, as amended, this subsection would apply only to appeals based on valuation. It also creates a new subsection (b2) to address appeals based on an application for exemption or exclusion. Appeals based on a county's authority to tax are covered under current law in G.S. 105-381.
This section establishes a process for the collection of property tax on an unregistered vehicle. The objective of the process is to ensure that the taxpayer is not double-taxed and that property taxes are paid on motor vehicles that a person owns even if it is not registered. If a person does not register or renew registration, then the person would be required to list the vehicle with the county assessor. The listing will generate a tax bill. However, if the person subsequently registers or renews the tag for the vehicle, then DMV will charge the person for the registration plus the property tax. This provision allows a county to ignore the listing to the extent the person registered or renewed within the same year.

[199] A taxpayer has 30 days to appeal a determination of value or eligibility for an exemption or exclusion. However, there is a five-year period to appeal an "illegal" tax under G.S. 105-381.

This section clarifies that counties would have authority to use collection remedies for unpaid motor vehicle taxes that were billed prior to the effective date of the combined motor vehicle/property tax system. The August 1 date is used because the tax year for July renewals begins August 1. It allows 45 days before the second month's interest begins. This is needed due to DMV's business process which DOR thinks may cause some taxpayers who pay by mail to get caught in a loop of sending in the payment after the due date, and the payment would be rejected. Without this change, the next month's interest would start before they got the correct amount mailed back in to DMV. This section also changes the term "tax collector" to "collecting authority" because under the new system, DMV and not the county tax assessor or tax collector will be the collecting authority.
This section repeals an unnecessary statute that relates to small underpayments and overpayments of motor vehicle taxes. Specifically, if a taxpayer fails to remit the additional $1.00 charged for payments that are mailed rather than paid in-person, the collecting authority is not permitted to bill or attempt to collect the additional $1.00. However, there is no longer a $1.00 charge for mailed in payments so the provision is unnecessary.
This section is a conforming change to the effective date. When the effective date for the implementation of the combined system was changed, this particular session law was missed.

Expand Setoff Debt Collection Act.

Session Law	*Bill #*	*Sponsor*
S.L. 2012-88	**HB 605**	**Representative McElraft**

AN ACT TO EXPAND THE DEFINITION OF LOCAL AGENCY FOR PURPOSES OF THE DEBT SETOFF COLLECTION ACT.

OVERVIEW: This act allows counties that jointly operate a solid waste facility as a regional solid waste management authority the same collection tool that would be available to them if they operated the facility individually. It does so by adding a regional solid waste management authority to the list of local agencies authorized under the Setoff Debt Collection Act to collect debts owed to them by obtaining a setoff against a debtor's North Carolina tax refund.

FISCAL IMPACT: This act has no fiscal impact.

EFFECTIVE DATE: This act becomes effective January 1, 2013, and applies to tax refunds determined by the Department of Revenue on or after that date.

ANALYSIS: This act allows a regional solid waste management authority created under Article 22 of Chapter 153A of the General Statutes to participate under the Setoff Debt Collection Act in the same manner as counties and cities.

The Setoff Debt Collection Act authorizes State and local agencies to collect debts by diverting part or all of a debtor's North Carolina tax refund to pay a debt that an individual or a business owes to a particular agency. Before January 1, 2001, the setoff program was open only to

State agencies. Now, counties and municipalities participate through a clearinghouse.[200] While the use of debt setoff for State agencies is mandatory, usage by local agencies is optional. The Act only applies to debts that are at least $50 and to a refund that is at least this same amount. Local agencies are required to give written notice to the debtor of the intent to submit the debt for setoff, explaining the basis for the agency's claim, that the agency intends to apply the debtor's refund against the debt, and that an administrative fee of $15 will be charged.

Most counties operate their own landfill and recycling operations, and as such may use the Setoff Debt Collection Act. However, ten counties came together for economies of scale to provide these services as a regional authority. This act allows the counties that operate their solid waste management services collectively to have the same collection tool available that would be available to them if they operated the service individually. Currently, there are only two regional authorities:

- Coastal Regional Solid Waste Management Authority, which is comprised of Carteret, Craven, and Pamlico Counties.
- Albemarle Regional Solid Waste Authority, which is comprised of Perquimans, Chowan, Gates, Dare, Currituck, Hyde, and Tyrell Counties.

Unemployment Insurance Changes.

Session Law	*Bill #*	*Sponsor*
S.L. 2012-134	**SB 828**	**Sen. Rucho, Hartsell**

AN ACT TO MAKE CHANGES TO THE UNEMPLOYMENT INSURANCE LAWS.

OVERVIEW: This act includes several changes to the unemployment laws that fall within the following categories:

- The extension of the three-year look-back period from January 1, 2012, to January 1, 2013. The extension became effective when the Governor signed the act into law on June 29, 2012, and applies retroactively to January 1, 2012.
- The resolution of outstanding issues associated with S. L. 2011-401, Senate Bill 532. These changes became effective November 1, 2012.
- The statutory changes required to comply with the federal Trade Adjustment Assistance Extension Act of 2011. The changes to the New Hire Directory became effective when the Governor signed the act into law on June 29, 2012. The remaining two changes become effective October 1, 2013.
- The recommendations of the House Unemployment Fraud Task Force. The criminal law changes become effective December 1, 2012. The reporting requirements became effective when the Governor signed the act into law on June 29, 2012. The remaining changes become effective October 1, 2012.

[200] Because there are so many local agencies, funneling their claims through a clearinghouse avoids an undue administrative burden on the Department of Revenue. A $15.00 collection assistance fee is added to each local agency debt submitted for setoff, which is remitted to the clearinghouse that submitted the debt. The fee does not, however, apply to child support debts.

- Administrative changes requested by the Division of Employment Security (DES). These changes became effective when the Governor signed the act into law on June 29, 2012.

FISCAL IMPACT: This act has no fiscal impact.

EFFECTIVE DATE: The effective dates are included in the Overview.

ANALYSIS:

Part I: Change in the Law to Continue the Three-Year Look-Back Trigger for Extended Benefits

There are two permanent benefit programs required by federal law: regular unemployment insurance (UI) benefits and extended benefits. Regular UI benefits are fully funded by the State through its State Unemployment Insurance Trust Fund and claimants in North Carolina are eligible to receive benefits for up to 26 weeks under it. Extended benefits are available in a state when the state is experiencing high levels of unemployment. The program is funded 50% by state contributions and 50% by the federal government. However, the federal government has paid 100% of the extended benefit claims since February 22, 2009.

Extended benefits are triggered in a state when the unemployment rate is at least 6.5% and at least 10% higher than it was at the same time in either of the past two calendar years. This two-year window is known as the "two-year look-back." In the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Congress enabled more states to offer extended benefits by allowing the states to amend their laws to temporarily increase the two-year look-back period to a three-year look-back period. Under the 2010 federal legislation, the temporary measure ended December 31, 2011. Congress extended the temporary measure twice. It is currently set to expire December 31, 2012.

The language of the federal law clearly states that a "State may by law" provide for the temporary look-back extension. However, the Governor acted unilaterally through executive orders to extend the look-back period on two different occasions. Section 1 of the act does two things:

- It calls attention to the Governor's lack of authority to make the UI law changes by executive order and states that any executive order on this issue would be void unless the order is issued upon authority that is conferred expressly by an act of the General Assembly or granted specifically to the Governor by Congress.
- It acknowledges that the General Assembly validated the effects of Executive Order 93 when it enacted S.L. 2011-145, Section 6.16; and that it is validating the effects of Executive Order 113 by the extension of the three-year look-back sunset from January 1, 2012, until January 1, 2013. As a practical matter, extended benefits will not be allowed in North Carolina for claim weeks later than May 12, 2012, because the State's unemployment rate fell below the three-year look-back trigger.

Part II: Resolution of Outstanding Issues from S.L. 2011-401, Senate Bill 532

The General Assembly enacted Senate Bill 532[201] on July 26, 2011, over the Governor's veto of the legislation on June 30, 2011.[202] In the Governor's Objections and Veto Message, she

[201] Senate Bill 532 created DES within the Department of Commerce and transferred the functions of ESC to DES; it made DES subject to rulemaking; and it made substantive and conforming changes to the UI laws.

[202] The Senate passed the bill on June 2, 2011, by a vote of 43 to 5. The House passed the bill on June 15, 2011, by a vote of 104 to 12.

stated the U.S. Department of Labor (USDOL) informed the administration that a lack of conformity between the bill and federal law could result in a loss of money for the State's UI program and a reduction in the FUTA tax credit.[203] After the General Assembly overrode the Governor's veto, the Employment Security Commission informed the General Assembly by a letter dated October 12, 2011, of its intention to suspend the provisions of the act determined by the USDOL to be noncompliant with federal law. G.S. 96-19(b) gives the DES the authority to suspend enforcement of a provision upon receiving notification from USDOL that a provision is noncompliant with the requirements of federal law. The suspension may be in effect until the Legislature next has an opportunity to reconsider the provisions purported to be noncompliant with federal law.

Part II of S.L. 2012-134 addresses the areas of concern noted by USDOL. The changes were shared with USDOL and have been found to be in compliance with federal law. The following changes became effective November 1, 2012:

Payment of UI benefits with the greatest promptness that is administratively feasible. - Senate Bill 532 expanded from 10 days to 30 days the time for an employer to provide information required to protest a claim. The USDOL noted that the extension of time would make it virtually impossible for the agency to make timely determinations under the standards set by federal regulations. The act provides that an employer has 10 days from the delivery of notice of the filing of a claim against the employer's account to protest the claim.

Misconduct connected with work and total reduction of benefit rights. - An individual is totally disqualified from receiving benefits if the DES determines the individual was discharged for misconduct connected with the work. Senate Bill 532 expanded the definition of "misconduct connected with the work" to include both of the following:

- *Arrest for or conviction of certain criminal offenses.* – USDOL noted that the new definition did not require that the criminal conduct be connected with the individual's work. The act provides that the offense must be related to the employee's work with the employer or in violation of a reasonable work rule or policy. It also amends a previous provision in North Carolina's law concerning the conviction of a person for drug offenses to make the same clarification that the offense be related to the employee's work with the employer or in violation of a work rule or policy.
- *Failure to adequately perform employment duties after being warned by three written reprimands within a 12-month period.* – USDOL noted that, in order to be the basis for a disqualification to receive UI benefits, unsatisfactory job performance must be the result of intentional behavior or gross negligence and must be egregious. The act provides that three written reprimands within a 12-month period is prima facie evidence of an employee's failure to adequately perform employment duties; this presumption may be rebutted by the claimant.

Stipulation of the issues and the methods of administration requirement. - Senate Bill 532 allowed the parties to tender stipulation of the ultimate issues in cases pending on appeal to the agency and provided that the stipulation did not have to be recorded. USDOL noted that while a stipulation of facts might be acceptable, a stipulation of the issues vitiates the agency's federally-mandated responsibility to apply the unemployment law to specific facts. USDOL also

[203] A state's law must conform to the provisions of the federal unemployment compensation laws in order for employers in the state to be eligible for a credit against the FUTA tax and for the state to be eligible to receive an administrative grant to operate its unemployment compensation programs.

recommended that any procedure or process by which an appeals referee or hearing officer accepts a stipulation of fact should be recorded. The act allows parties to agree to a stipulation of facts. The appeals referee or hearing officer may accept the stipulation if the stipulation provides sufficient information to make a UI benefit decision. If the stipulation does not provide sufficient information, the appeals referee or hearing officer must reject the stipulation. The decision to accept or reject the stipulation of facts must occur in a recorded hearing.

Salaries for Board of Review. – Senate Bill 532 created a Board of Review to determine appeals policies and procedures and to hear appeals arising from the decisions and determinations of the Employment Security Section and the Employment Insurance Section. The annual salaries of the three-person board are to be set by the General Assembly in the current Operations Appropriations Act. The Current Operations and Capital Improvements Appropriations Act of 2011 did not set the salaries for the members of the Board of Review. The act states that the current Operations Appropriations Act of 2012 must provide for the annual salaries of the Board of Review. S.L. 2012-142, The Current Operations and Capital Improvements Appropriations Act of 2012, set the salaries of the Board of Review: an annual salary of $120,737 for the two members and an annual salary of $122,255 for the chair.

Part III: Compliance with the Trade Adjustment Assistance Extension Act of 2011

In 2002, the United States General Accounting Office issued a report on the UI program and the need for an increased focus on program integrity. The focus of President Obama's Executive Order 13520, issued November 23, 2009, was the reduction of improper payments in major programs administered by the federal government, including the UI program. In response to the level of improper payments in the UI program, the USDOL developed a strategic plan to address the root causes of improper payments. The plan involves new performance measures for the states; increased funding of new tools and technology; and a focus on the root causes leading to improper payments. The three identified root causes leading to improper payments are:

- A gap in employment service registration.
- Untimely and insufficient separation information from employers and third party administrators.
- Claimants continuing to claim benefits after returning to work.

As part of the increased focus on program integrity, USDOL recommended legislative language to Congress in June of 2011. In October 2011, three key integrity provisions recommended by USDOL were enacted as part of the Trade Adjustment Assistance Extension Act of 2011. The act includes the statutory change North Carolina must make to be in conformity with the program integrity provisions this year as well as the statutory changes for the two provisions that must be enacted prior to October 21, 2013.

New Hire Directory. – The New Hire Directory was created years ago to assist states with the collection of child support payments. The Directory is administered by the Department of Health and Human Services. The directory is also a valuable tool for UI programs because it allows an agency to cross-check claimants with new hires. This information assists the agency with the detection of overpayments being made to individuals who have returned to work. To address the gap in employment service registration, the Trade Adjustment Assistance Extension Act of 2011 requires states to expand the definition of a "newly hired employee" to include a rehired employee who was separated for at least 60 days. It also requires employers to enter the start date of employment when the employer submits the information to the New Hire Directory.

States are required to make the necessary statutory changes to its New Hire Directory provisions within two months after the latest legislative session ends. The act includes the necessary changes, effective July 1, 2012.

Prohibition on Non-Charging of Employer Accounts. – To address the untimely and insufficient separation information provided by employers and third party administrators to the state unemployment agencies, the federal law requires states to enact a provision prohibiting the non-charging of an employer's UI account when an improper payment is made because of the employer's failure to respond timely or adequately to a written request for separation information. In most states, an employer's state unemployment tax rate is based upon an experience rating whereby employers that have more claims or charges against their UI account have a higher tax rate. Under current law, benefits paid to a claimant erroneously may not be charged to the employer's account. Under this provision, the benefits would be charged to the employer's account if the erroneous payment is made because the employer failed to respond timely and adequately to the agency. This provision points to a trend whereby employers are expected to improve the quality of information provided to state employment agencies at the front end of the UI claim process, rather than waiting until a hearing to provide details. The act makes the necessary changes to impose the federally-mandated penalty; it does not impose a larger state penalty. The changes become effective October 1, 2013, and apply to an overpayment established on or after that date.

Monetary Penalty Assessment. – To address claimants who fraudulently continue to accept UI benefits after returning to work, the federal law requires states to impose a penalty on the claimant equal to 15% of the amount of erroneous overpayment if the agency determines that the overpayment is due to fraud. Under G.S. 96-18(a), a fraudulent overpayment is one that results from a person's false statement or representation knowing it to be false or from a person knowingly failing to disclose a material fact to obtain or increase a benefit received. The money collected from the penalty is payable to the State Unemployment Trust Fund and its use is limited to the payment of UI benefits. States may enact a larger penalty amount and may use the additional amount for whatever purpose it desires. The act makes the necessary changes. They become effective October 1, 2013, and apply to a fraudulent overpayments on or after that date.

Part IV: Enhance Unemployment Compensation Fraud Detection and Recovery, as Recommended by the House Unemployment Fraud Task Force

The House Unemployment Fraud Task Force met three times and spent time considering the differences between overpayments and fraudulent overpayments. An overpayment may occur when funds go to the wrong recipient; when the right recipient receives the wrong amount; and when documentation is not available to support a UI claim. Not all overpayments are fraudulent. An overpayment is considered fraudulent when the claimant makes a false statement or representation knowing it to be false or knowingly fails to disclose a material fact to obtain or increase any UI compensation benefit.

One of the leading causes of overpayments is a person continuing to claim benefits after returning to work. The Task Force learned that proving a person knowingly made a false statement is sometimes difficult when the overlap of benefits and earnings is for a limited period of time. Claimants who return to work, but don't receive a paycheck for a period of two to four weeks after starting employment, sometimes fail to correctly answer the question asked regarding weekly earnings.

The implications of an overpayment versus a fraudulent overpayment are as follows:

- A person who has been found to have obtained a benefit fraudulently is not entitled to receive benefits for a period of 52 weeks.
- A person who has been found to have obtained a benefit fraudulently is guilty of a Class 1 misdemeanor.
- DES has 10 years to recover a fraudulent overpayment; it has only three years to recover an overpayment.
- DES may recover a fraudulent overpayment by deducting 100% of the overpayment from future benefits payable to the person; it may deduct only 50% from future benefits for a non-fraudulent overpayment.

The act makes the following changes to enhance DES's ability to recover overpayments:

- Makes it a Class I felony to wrongfully obtain or increase an UI benefit if the amount wrongfully obtained exceeds $400. The felony penalty provision mirrors the current criminal provision for wrongfully obtaining a benefit under the Medicaid Program. This change becomes effective December 1, 2012, and applies to offenses committed on or after this date. Under current law, it is a Class 1 misdemeanor.
- Removes the statute of limitations for recovering any overpayment. This change becomes effective October 1, 2012, and applies to an overpayment established on or after this date. Under current law, the statute of limitations for recovering on overpayment is three years and for recovering a fraudulent overpayment is 10 years.

The Task Force learned about the Unemployment Insurance Compensation Debt of the Treasury Offset Program (TOP-UIC). The TOP compares payee names and taxpayer identification numbers on federal payment certification vouchers to names and taxpayer identification numbers in TOP's debtor database. When a match occurs, TOP intercepts, or "offsets," all or part of a payee's eligible Federal or state payments. Congress first permitted UI compensation debts and uncollected contributions to be recovered under TOP in 2008. The initial legislation limited the types of UI debts that could be recovered through TOP. However, in December 2010, Congress removed many of the limitations. Today, the definition of "covered unemployment compensation debt" is no longer limited to overpayments due to fraud and any associated penalties or interest may be recovered through TOP if the UI compensation debt is due to a person's failure to report earnings or delinquent contributions. In addition, the term is no longer limited to debts that remain uncollected for 10 years.

To participate in the TOP-UIC, a state must have a Safeguards Procedure Report approved by the IRS, must send debtors 60 days-notice of the State's intent to send the debt to TOP-UIC, and must complete several forms required by the Financial Management Service of the US Treasury Department. As of April 16, 2012, 14 states are participating in the TOP-UIC. Those states have recovered more than $140.6 million in tax refund payment offsets since February 2011.

Assistant Secretary for the DES, Dempsey Benton, indicated DES was pursuing the implementation of the TOP-UIC for North Carolina. The act notes the desire of the General Assembly that DES participate in the refund offset program on or before January 1, 2013. To that end, the act requires DES to report on its implementation of the program to the House Unemployment Fraud Task Force on September 1, 2012, November 1, 2012, and January 1, 2013.

Part V: Technical Changes Requested by the Division of Employment Security

Last session, as part of the reorganization of the Employment Security Commission, the information management system was placed under the Labor and Economic Analysis Division of Commerce. The act notes this change of responsibility in Article 4 of Chapter 96 of the General Statutes. The changes became effective when signed into law on June 29, 2012.

Part VI: NC Facts Program

The House Unemployment Fraud Task Force learned the importance of using cross-matching to discover and recover UI benefit overpayments. Cross-matching is a key tool in overpayment prevention, detection, and recovery. The act makes the necessary changes to enable DES to participate in NC FACTS by insuring that any disclosure made must conform to the confidentiality requirements of federal law. The changes became effective when signed into law on June 29, 2012.

NC FACTS is the North Carolina Financial Accountability and Compliance Technology System. It is a program designed to identify fraud, waste, and improper payments across State agencies. In 2007, the General Assembly directed the Office of the State Controller (OSC) to develop a strategic plan for the integration of databases and sharing of information among State agencies and programs. Since 2008, OSC has managed the Statewide Data Integration Program, including the design, development and statewide implementation of Criminal Justice Law Enforcement Automated Data Services (CJLEADS) criminal justice data integration program. Last year, in S.L. 2011-145, the General Assembly directed OSC to expand the data integration program by developing an enterprise process to detect fraud, waste, improper payments across State agencies. OSC has contracted with SAS to design, develop, and host NC FACTS.

Modify 2011 Appropriations Act.

Session Law	*Bill #*	*Sponsor*
S.L. 2012-142, as amended by S.L. 2012-145	**HB 950**	**Representative Brubaker**

AN ACT TO MODIFY THE CURRENT OPERATIONS AND CAPITAL IMPROVEMENTS APPROPRIATIONS ACT OF 2011 AND FOR OTHER PURPOSES.

OVERVIEW: This act caps the motor fuel tax rate at 37½¢ cents a gallon for one year, July 1, 2012, through June 30, 2013, and it authorizes the Secretary of Revenue to enter into a public-private partnership for the purpose of expanding the implementation of the Tax Information Management System (TIMS).[204]

FISCAL IMPACT: The cap on the motor fuel tax rate reduces Highway Fund revenues by $46.65 million in FY 2012-13 and reduces Highway Trust Fund revenues by $15.55 million in FY 2012-13. *(For a more complete fiscal analysis, see Finance Committee Highlights, 2012 Session, available online at www.ncleg.net.)*

[204] Section 24.21 of the act prohibits DOT from establishing or collecting tolls on I-95 prior to July 1, 2014. Originally, Section 24.18 of the act required DOT to collect the increased tolls on various ferry routes. However, Section 6.2 of S.L. 2012-145 reversed this provision by prohibiting DOT from collecting the increased ferry tolls during FY 2012-13.

EFFECTIVE DATE: This act became effective on July 1, 2012, when the General Assembly overrode the Governor's veto on July 2, 2012. [205]

ANALYSIS: This act contains the following finance-related provisions:

Reduce Motor Fuel Excise Tax Rate.[206] – Section 24.11 effectively reduced the motor fuel excise tax rate for the period July 1, 2012, through June 30, 2103, by placing a cap on the rate of 37.5¢ per gallon. With a cap, the rate may fall below 37.5¢ per gallon for the period July 1, 2012, through June 30, 2013, but it may not exceed it. Without this change the rate would have decreased from 38.9¢ per gallon to 37.7¢, effective for the period July 1, 2012, through December 31, 2012; however, without this change, it is projected that the rate would have increased to 38.8¢ a gallon for the period January 1, 2013, through June 30, 2013.

A motor fuel excise tax is imposed on all motor fuel sold, distributed, or used in the State. The motor fuel tax rate has two components: a flat rate of 17.5¢ and a variable rate that may change every six months.[207] The variable rate is equal to 7% of the wholesale price of gasoline based on a weighted average price of gasoline and diesel, as reported by the US DOE Energy Information Administration. The variable rate decreased from 21.4¢ to 20.2¢, effective July 1, 2012, based on the six-month period that ended March 31. However, it is projected that the variable rate effective January 1, 2013, would be higher based on the wholesale price of gasoline over the last few months. The variable tax rate effective January 1, 2013, would be based on the wholesale price of gasoline during the period April 1, 2012, through September 30, 2012.

The revenue generated by the motor fuel tax is distributed as set forth in G.S. 105-449.125. One-half cent of the excise tax on each gallon of gas is distributed to funds for underground tank storage cleanup water and air quality. The remaining excise tax revenue is allocated as follows:

- 75% to the Highway Fund and used for maintenance, transit, rail, State Highway Patrol, DMV, some secondary road improvement, Powell Bill distribution to local governments, and some other administrative needs. G.S. 105-449.126 credits 1/6 of 1% of this amount annually to the Wildlife Resources Fund to be used for the boating and water safety activities described in G.S. 75A-3(c).[208]

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[205] The failure of the act to be enacted on or before July 1, 2012, created initial uncertainty about the motor fuel excise tax rate. Section 61.2 of S.L. 2012-194 contained a savings clause to relieve a taxpayer from liability if the taxpayer over-collected or under-collected the excise tax on motor fuel if the taxpayer made a good faith effort to comply with the law.

[206] The House passed a similar provision in House Bill 645 during the special session held in November, 2011, and in House Bill 142 earlier this session.

[207] The variable rate component was introduced in 1986 as part of legislation that increased funding for road construction. In addition to the introduction of a 3% variable rate, which equated to 1.5¢ per gallon at that time, the legislation increased the flat rate from 12¢ per gallon to 14¢ per gallon. The General Assembly incorporated the variable rate in part as recognition that the cost of road construction increases as the cost of motor fuel increases because of the petroleum products used in road construction. In 1989, the General Assembly increased the flat tax rate to 17¢ per gallon and increased the variable component from 3% to 7% of the average wholesale price. In 1992, the tax rate was changed to the current rate of 17.5¢ per gallon plus 7% of the average wholesale price (S.L. 1991-538).

[208] The reduction in the motor fuel tax rate reduces the amount credited to the Wildlife Resources Fund by $197,000 for fiscal year 2012-13.

- 25% to the Highway Trust Fund and used for construction of the intrastate system, some secondary road improvement, and Powell Bill distribution to local governments.

Tax Information Management System/Additional Public-Private Partnership Authorized. – Section 6A.3 authorizes the Secretary of Revenue to enter into an additional public-private arrangement in order to expand the implementation of TIMS.

For the last several years, the Department of Revenue has been in the process of implementing a new computer system known as the Tax Information Management System, which is designed to manage all tax schedules administered by the Department under one computer system. The new system will be phased in over a period of time as information is transferred from the current tax systems to TIMS.

This provision is an extension of authority that has been authorized each year since 2009, and all arrangements under this authority must terminate on June 30, 2018. The section appropriates additional sums from increased revenues or cost savings generated by the project under the public-private arrangement to cover the payment of internal costs and new resources necessary to provide additional electronic services, including the processing of payments and returns. The Department is required to report quarterly to the Chairs of the Appropriations Committees, the Joint Legislative Oversight Committee on Information Technology, and to the Fiscal Research Division of the General Assembly on the details of each public-private contract, the benefits from each contract, and a comprehensive forecast of using public-private agreements to implement TIMS.

Contingency Contracts for Audits/Assessments.

Session Law	*Bill #*	*Sponsor*
S.L. 2012-152, as amended by S.L. 2012-194	**HB 462**	**Representative McCormick**

AN ACT TO LIMIT USE OF CONTINGENT-BASED CONTRACTS FOR AUDIT OR ASSESSMENT PURPOSES.

OVERVIEW: This act prohibits the Department of Revenue, local governments, and the State Treasurer from using third-party contractors paid on a contingent fee basis for audit and assessment purposes. The State Treasurer retains the authority to use a contingent fee contract with a maximum compensation of 12% of the final assessment for audits of unclaimed death benefits and unredeemed bond funds.

FISCAL IMPACT: This act has no fiscal impact at the State level.

EFFECTIVE DATE: The portion of the act relating to the Department of Revenue and the State Treasurer becomes effective October 1, 2012. The portion of the act relating to local governments becomes effective July 1, 2013, and expires July 1, 2015. *S.L. 2015-109 removed the sunset. Effective July 1, 2013, local governments cannot renew or enter into new contracts with an auditing firm for audit or assessment purposes that are contingency fee-based.*

ANALYSIS: Local governments and the State Treasurer currently contract with third-party auditors to search for unpaid taxes and other collectable funds. The contracts between the governmental entities and third parties may compensate the third-party auditors on a contingency fee based on the amount assessed or collected. The purpose of the act is to remove

any conflict of interest between the correct assessment of liability and the third parties' financial interest in maximizing compensation under the contract.

State Government. – Section 1 of the act prohibits the Department of Revenue from contracting with an entity paid on a contingent fee basis to determine the tax liability of any taxpayer. The Department is authorized to outsource the collection of tax debts under G.S. 105-243.1, but the Department does not use third-party contractors to determine tax liability. The Department does use third-party contractors to collect tax debts from out-of-state taxpayers. The Department does not anticipate any changes in operation based on section 1 of this act.

Section 3 of the act prohibits the State Treasurer from contracting with entities paid on a contingent fee basis for administration of the Unclaimed Property Act. G.S. 116B-8 authorizes the State Treasurer to employ persons with specialized knowledge such as consultants and real estate managers. Section 3 contains an exemption to the prohibition for audits of life insurance companies where the audit is being conducted for the purpose of identifying unclaimed death benefits or to conduct audits of holders of unredeemed bond funds. These auditors may be paid on a contingent fee basis, but the contingency fee may not exceed 12% of the final assessment.[209] This exception allows the State Treasurer to participate with other states to use national firms to audit the voluminous records of life insurance companies.

Section 3.1 of the act allows the State Treasurer to use funds from the Escheat Fund to pay for consultants possessing specialized skills or knowledge to conduct audits for the administration of the Unclaimed Property Act. This authority allows the State Treasurer to continue to use third-party auditors paying the auditors from the Escheat Fund.

As originally enacted, these sections would have become effective July 1, 2012. Section 61.5 of S.L. 2012-194 changed the effective date. As amended, these three sections become effective October 1, 2012, and the Treasurer may not renew any contingency fee-based contracts for these services after October 1, 2012. Furthermore, the Treasurer may not assign further audits on a contingency fee basis to an auditing firm under a contract that meets both of the following conditions: (i) the contract would have been prohibited under this act had the contract been entered into after October 1, 2012, and (ii) the contract allows the assignment of audits on a discretionary basis by the Treasurer.

Local Governments. – Section 2 of the act prohibits counties from employing entities paid on a contingent fee basis to assist a county tax assessor. The board of county commissioners has the authority under G.S. 105-299 to use third parties to assist the assessor in the performance of the assessor's duties.

Section 4 of the act prohibits counties from employing agents paid on a contingent fee basis to determine the tax liability of any taxpayer when imposing taxes. This prohibition limits the authority under G.S. 153A-146 for counties to impose taxes and administer tax collection.

Section 5 of the act prohibits cities from employing agents paid on a contingent fee basis to determine the tax liability of any taxpayer when imposing taxes. This prohibition limits the authority under G.S. 160A-206 for cities to impose taxes and administer tax collection.

As originally enacted, these sections would have become effective July 1, 2012. Section 61.5 of S.L. 2012-194 changed the effective date. As amended, these three sections become effective July 1, 2013, and expire July 1, 2015. During this two-year time period, a city or a county may not renew any contingency fee-based contracts for these services. Furthermore, a

[209] The contingency fee cap of 12% was removed from the statute by this act and restored by Section 61.5 of S.L. 2012-194.

city or a county may not assign further audits on a contingency fee basis to an auditing firm under a contract that meets both of the following conditions: (i) the contract would have been prohibited under this act had the contract been entered into after July 1, 2013, and (ii) the contract allows the assignment of audits on a discretionary basis.

Public Finance Laws/Municipal Service Dists.

Session Law	*Bill #*	*Sponsor*
S.L. 2012-156	**SB 426**	**Senator Clodfelter**

AN ACT TO MAKE CLARIFICATIONS AND MODIFICATIONS TO THE PUBLIC FINANCE STATUTES OF NORTH CAROLINA FOR THE IMPROVEMENT OF VARIOUS FINANCING STRUCTURES AND THE TERMS AND PROVISIONS OF THE FINANCING STRUCTURES AND TO AUTHORIZE A RESOLUTION ESTABLISHING A MUNICIPAL SERVICE DISTRICT TO BECOME EFFECTIVE UPON A DATE SPECIFIED IN THE RESOLUTION IF SPECIAL OBLIGATION BONDS ARE ANTICIPATED TO BE AUTHORIZED FOR A PROJECT.

OVERVIEW: This act does two things:

- It makes changes to the local government bond statutes designed to improve their efficiency.
- It authorizes a resolution establishing a municipal service district to become effective upon a date specified in the resolution, as opposed to July 1.

FISCAL IMPACT: This act has no fiscal impact.

EFFECTIVE DATE: This act became effective when the Governor signed it into law on June 28, 2012.

ANALYSIS:

Bond Statute Changes. – Under the Local Government Budget and Fiscal Control Act, an obligation may not be incurred by a city or county unless there has been an approved appropriation authorizing the payment of the obligation. For an obligation evidenced by a contract, an agreement, or a purchase order, the finance officer must have a certificate attached to the appropriate instrument stating the instrument has been pre-audited to assure that the obligation is an approved appropriation. An obligation incurred in violation of this requirement is invalid and may not be enforced. Section 1 of the act eliminates the need for the pre-audit certificate if the document has been approved by the Local Government Commission (LGC). The LGC approves all contractual obligations related to the financing of capital projects, including bond purchase agreements, credit facilities, repayment agreements, remarketing agreements, interest swap agreements, and installment purchase contracts. The approval by the LGC provides a "check" as a preaudit certification.

Under prior law, the Local Government Bond Act had a three-step process for adopting a bond order:

1. The governing body of a local government unit authorizes the filing of an application to issue general obligation bonds with the LGC in a formal meeting.

2. The LGC approves the application for the issuance of the revenue bonds. The governing body cannot adopt a bond order until the LGC has received and acknowledged receipt of the application requesting approval to issue GO bonds.
3. The governing body introduces a bond order in a formal meeting. The bond order is the formal resolution which specifies the details of the bonds being put to a vote: the purpose of the bond, the amount of the bond, the source of revenues for repayment of the bond, etc. The law then requires other meetings after the bond order is introduced, such as a public hearing.

Sections 2 and 3 of the act make this a two-step process by removing the restriction that the LGC must acknowledge receipt and approval of the bond application before the governing body may adopt a bond order[210] thus allowing a governing body to adopt the bond order at the same meeting in which it initiates the bond process with the application.[211]

Municipal Service District Changes. – Article V, Sec. 2(4) of the North Carolina Constitution allows the General Assembly to enact general laws authorizing the governing board of a local governmental unit to define territorial areas and to levy additional taxes within those areas to finance a service that is provided to a greater extent in that area than is provided to the entire area of the governmental unit. The purposes for which a service district may be created are: beach erosion control and flood and hurricane protection works; any service which the municipality may by law provide, such as placing utility wiring underground; downtown revitalization projects; transit-oriented development projects; drainage projects; sewage collection and disposal systems; lighting at interstate highway interchange ramps; off-street parking facilities; and watershed improvement projects.

Based on that provision, Article 23 of Chapter 160A authorizes a city to define a municipal service district and to levy a property tax in that district that is in addition to those levied through the city. A city may also incur debt, as allowed under general law, to finance services within a service district and may allocate any other revenues whose use is not otherwise restricted by law. When there is no longer a need for the service district, the district may be abolished.

To create a district, a city must hold a public hearing on a proposed resolution. The resolution must define the service district and find that the area defined is in need of one or more of the services for which a district may be created to a demonstrably greater extent than the remainder of the city. Under prior law, a resolution establishing a municipal service district could only become effective either (1) at the beginning of the next fiscal year,[212] or (2) immediately, if it is anticipated that general obligation bonds will be issued for a project.

Section 4 of this act authorizes a resolution establishing a municipal service district to become effective upon a date specified in the resolution if special obligation bonds are anticipated to be authorized as funding for a project, as opposed to property tax revenues. North Topsail Beach would like to create a municipal service district for the purposes of beach erosion control. It plans to issue special obligation bonds. Under the prior law, it would have to have waited until July 1, 2013, to form the district. This change in the law enables the Town to proceed more quickly because it allows the Town, and any other city, to create a service district that could become effective upon a date set in the resolution creating the district.

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[210] Section 3.
[211] Section 2.
[212] No ad valorem tax may be levied for partial fiscal year.

Modify Taxation of HOA Property.

Session Law	*Bill #*	*Sponsor*
S.L. 2012-157	**HB 1105**	**Representative Justice**

AN ACT TO SIMPLIFY THE COLLECTION OF PROPERTY TAXES THAT ARE DUE ON PROPERTY OWNED BY CERTAIN NONPROFIT HOMEOWNERS ASSOCIATIONS.

OVERVIEW: This act simplifies the collection of property taxes due on extraterritorial common property owned by nonprofit homeowners associations (HOA). The legislation is based upon a recommendation of the House Select Committee on Homeowners Associations.

FISCAL IMPACT: This act has no fiscal impact at the State level.

EFFECTIVE DATE: This act became effective for taxes imposed for taxable years beginning on or after July 1, 2012.

ANALYSIS: G.S. 105-277.8 provides that the value of real and personal property owned by a HOA must be included in the appraisals of property owned by members of the HOA and not be assessed against the HOA if each of the following requirements are met:

- All property owned by the HOA is held for the use, benefit, and enjoyment of all members of the HOA equally.
- Each member of the HOA has an irrevocable right to use and enjoy all the property owned by the HOA subject to the rules, regulations or bylaws of the HOA.
- Each irrevocable right to use and enjoy all the property owned by the HOA is appurtenant to taxable real property owned by a member of the HOA.

The genesis for this act is because instances have arisen where HOAs purchased or were formed with property meeting these requirements but located in a separate taxing jurisdiction than the jurisdiction in which the HOA members reside. This property is defined by the act as "extraterritorial common property." Under prior law, the tax on the value of extraterritorial common property was incorporated into the members' residential property and remitted to the county of residence. This was problematic in that (1) if applied, counties would receive property taxes for property not located in the county, and (2) the assessor of the county with extraterritorial common property did not know the HOA membership.

This act modifies the property tax treatment of extraterritorial common property. Under the act, HOA extraterritorial common property is taxed in the jurisdiction in which it is located and to the HOA owner of record, which, in turn, recoups the taxes paid from its members. In order to ensure that developers do not use bylaws or covenants to escape paying taxes on portions of communities not yet sold, the act requires recoupment to be pro rata, based on the number of lots or units in the association. The value of extraterritorial common property is not included in the appraisals of property owned by the members of the HOA.

Nonappropriated Capital Projects.

Session Law	*Bill #*	*Sponsor*
S.L. 2012-164	**SB 444**	**Senator Hartsell**

AN ACT TO AUTHORIZE THE CONSTRUCTION AND THE FINANCING, WITHOUT APPROPRIATIONS FROM THE GENERAL FUND, OF CERTAIN CAPITAL IMPROVEMENTS PROJECTS.

OVERVIEW: This act authorizes the following capital projects:

- The construction of numerous projects by The University of North Carolina (UNC) to be financed through revenue bonds and special obligation bonds, not appropriations from the General Fund.
- Thirty-five capital projects to be financed with receipts or from other non-General Fund sources.

FISCAL IMPACT: The act authorizes $225,194,410 in new debt at the UNC campuses. It is expected that there will be an increase in operating requirements and associated positions at the campuses. These operating impacts are commonly referred to as building reserves. The act authorizes $27,851,143 in projects to be funded from non-General Fund sources at the various State agencies, should the funding become available. Various agencies listed insignificant increases to operating budgets as a result of the projects; fiscal research assumes the agencies can absorb costs from current budgeted sources. *(For a more complete fiscal analysis, see Finance Committee Highlights, 2012 Session, available online at www.ncleg.net.)*

EFFECTIVE DATE: This act became effective when the Governor signed it into law on July 12, 2012.

ANALYSIS: This act authorizes the following capital projects:

UNC Capital Improvement Projects. – The act authorizes the construction and financing of 16 capital improvement projects on eight campuses of UNC. The projects authorized by the act are not financed with funds appropriated from the State's General Fund but may be financed with gifts, grants, receipts, self-liquidating indebtedness, Medicare reimbursements for education costs, other funds available to the constituent institutions, or a combination of any of those financing methods. The projects include academic, research, clinical and administrative space and improvements to student services, residential living, dining, recreation, and athletics facilities. Once approved, a detailed financial plan will be developed in consultation with financial advisors and bond counsel for each project. The plans must be approved by the Chancellor, the Boards of Trustees, the President, and the Board of Governors before construction contracts may be awarded and bonds issued.

Under Article 8 of the State Budget Act, no State agency may expend funds for the construction or renovation of a capital improvement project unless authorized to do so by the General Assembly. The UNC Board of Governors may approve expenditures for projects that are to be funded entirely with non-General Fund money. However, under Article 3 of Chapter 116D, the General Assembly must approve the issuance of special obligation bonds for UNC projects. This act provides the necessary authorization and approval.

There are two types of self-liquidating bonds that may be issued by the UNC Board of Governors.

- Article 21 of Chapter 116 of the General Statutes authorizes the Board of Governors to issue revenue bonds for the types of projects enumerated in the Article. The types of projects for which revenue bonds may be issued include educational buildings, dormitories, recreational facilities, dining facilities, student centers, health care buildings, parking decks, etc. for the educational institutions, the University of North Carolina Health Care System, the University of North Carolina General Administration, and the University of North Carolina Hospitals at Chapel Hill. The revenue bonds are payable from rentals, charges, fees, and other revenues generated by the facility. The bonds are not payable from tax revenues.

- Article 3 of Chapter 116D of the General Statutes authorizes the Board of Governors to issue special obligation bonds payable with any sources of income or receipts of the Board of Governors or a constituent or affiliated institution, but not including tuition payments or appropriations from the General Fund from State revenues. The bond proceeds could be used for construction, improvement, and acquisition of any capital facilities located at UNC constituent and affiliated institutions. The project must be approved by the board of trustees for the respective institution for which the project is authorized and the General Assembly must approve the project and the maximum aggregate principal amount for the project. The bonds are not payable from tax revenues.

The self-liquidating projects the Board of Governors plans to finance with revenue or special obligation bonds are listed in Section 2 of the act. Section 3 authorizes the Board of Governors to expend non-General Fund money to plan six capital projects on four campuses. The Chancellors and Boards of Trustees for the listed campuses, as well as the President and the Board, have approved these projects. Support from General Fund sources for operating costs will be required only for facilities used for academic programs. Section 5 of the act expressly states that the maximum principal amount of special obligation bonds to be issued shall not exceed the amounts listed in Sections 2 and 3 of the act plus 5%. The additional 5% may be used for related additional costs for which bond proceeds are routinely used, such as issuance expenses, funding of reserve funds, and capitalized interest.

Sections 6 and 7 authorize UNC-Chapel Hill and Winston-Salem State University to construct and finance projects through lease arrangements to, from, and with named entities. Once constructed and approved by state reviewing agencies, the improvements would transfer to the respective institutions. The two projects are:

- Chilled Water Infrastructure Improvements capital project at UNC-Chapel Hill. The school will partner with the Orange Water and Sewer Authority.

- New Student Housing Building capital project at Winston-Salem State University. The school will partner with Winston-Salem State University Foundation, Inc. and Winston-Salem State University Housing Foundation, LLC.

Non-General Fund State Agency Capital Improvement Projects. – Section 8 authorizes the construction of 35 capital projects to be funded with non-General Fund sources totaling $27,851,143. These projects must be approved by the General Assembly each year. Section 9 directs the Division of Veterans Affairs of the Department of Administration to report on or before January 1, 2013, to the Joint Legislative Commission on Governmental Affairs on the status of the Committal Structure project located at the Sandhills Cemetery.

PPP Pilot Toll Project/Ferry Tolls.

Session Law	*Bill #*	*Sponsor*
S.L. 2012-184	**HB 1077**	**Rep. Frye, Mills**

AN ACT TO ALLOW THE DEPARTMENT OF TRANSPORTATION TO ENTER INTO A PILOT PUBLIC-PRIVATE PARTNERSHIP TOLL PROJECT AND TO REALLOCATE THE MONEY APPROPRIATED FOR STUDIES RELATED TO THE MID-CURRITUCK BRIDGE PROJECT TO THE DEPARTMENT OF TRANSPORTATION, FERRY DIVISION.

OVERVIEW: This act makes changes to the public-private partnership authority granted to the Department of Transportation (DOT) in 2006 to enable it to more effectively enter into such an agreement. The act is drafted to apply the changes to one project, the I-77 High Occupancy Toll Project.

FISCAL IMPACT: This act has no fiscal impact.

EFFECTIVE DATE: This act became effective when the Governor signed it into law on July 16, 2012.

ANALYSIS: In 2006, the General Assembly authorized DOT to enter into partnership agreements to finance transportation projects.[213] As part of this authority, DOT may finance the projects by tolls, contracts, and other financing methods authorized by law. Under Article 6H of Chapter 136, DOT has toll-setting authority for the projects specifically identified for The Turnpike Authority and on any existing interstate highway for which the US DOT has granted permission by permit to do so.

This act places some restrictions on DOT's authority to enter into partnership agreements to finance transportation infrastructure.[214] A financing agreement that extends beyond 18 months requires approval of the agreement by the Local Government Commission (LGC). The approval of the LGC is also required for contracts that commit DOT to make nonretainage payments for undisputed capital costs of a completed transportation infrastructure project later than 18 months after final acceptance by DOT of the infrastructure.

The changes below apply to a public-private partnership agreement that is a candidate for funding under the Mobility Fund, that is planned for construction through a public-private partnership, and for which a Request for Qualifications has been issued by the DOT no later than June 30, 2012. The only project that meets these requirements is the I-77 High Occupancy Toll project. This project runs from the junction at NC-150 at Exit 36 to I-277 at Exit 9B.

- Allows DOT to accept performance and payment security from a private entity to an agreement in a form and an amount that DOT determines is sufficient, rather than as provided under the generally applicable payment and performance bond statutes.[215]
- Allows the private entity to an agreement to transfer some or all of its interest under the agreement to a lender, bondholder, or any other party. In no event shall the assignment create additional debt or debt-like obligations of the State, DOT, or other subdivision of the State to any other party providing financing or funding of the project subject to

[213] S.L. 2006-230.
[214] G.S. 136-18.
[215] Article 3 of Chapter 44A of the General Statutes.

the agreement. This provision would apply in lieu of the State's general law on assignments of claims against the State.[216]

- Gives DOT the power to transfer its authority to fix, revise, charge, and collect tolls and fees with respect to a transportation infrastructure project to a private entity through an agreement.
- Allows DOT to act as a conduit issuer for private activity bonds. The issuance of private activity bonds would be governed by the State's revenue bond statutes[217] and the State's general law on adoption of a revenue bond order[218] if the bonds are obligations secured by a pledge of revenues allocated to a private entity under G.S. 136-18(39) and (39a).

Study Municipal Local Option Sales Tax.

Session Law	*Bill #*	*Sponsor*
S.L. 2012-189	**HB 1181**	**Representative McElraft**

AN ACT TO AUTHORIZE THE REVENUE LAWS STUDY COMMITTEE TO STUDY WHETHER MUNICIPALITIES SHOULD HAVE THE AUTHORITY TO LEVY A LOCAL OPTION SALES TAX FOR BEACH NOURISHMENT AND TO STUDY THE TAXATION AND VALUATION OF LEASEHOLD INTERESTS IN EXEMPT REAL PROPERTY.

OVERVIEW: This act authorizes the Revenue Laws Study Committee to study two different issues: (1) whether municipalities should have the authority to levy a local option sales tax for beach nourishment, and (2) the taxation and valuation of leasehold interests in exempt real property.

FISCAL IMPACT: This act has no fiscal impact.

EFFECTIVE DATE: This act became effective when the Governor signed it into law on July 16, 2012.

ANALYSIS: This act authorizes the Revenue Laws Study Committee to study two different issues. The first issue is whether municipalities should be granted the authority to levy a local option sales tax for the purpose of providing dedicated funding for beach nourishment and other natural resources preservation. The Committee may report its findings, together with any recommended legislation, to the 2013 Regular Session of the General Assembly upon its convening.

Counties and cities are created by the State and have only the authority given to them by the State. The General Assembly has authorized counties to levy a local option sales tax on at least four different occasions. The counties must distribute a portion of the 2% local sales tax revenues to the cities. The distribution between the county and its municipalities is based upon one of two methods: ad valorem or per capita. Cities may use this revenue for any public purpose, including beach nourishment.

The General Assembly has not authorized any cities to levy a city-only sales tax. Cities do have general authority to levy local privilege license taxes and vehicle taxes. Many cities have also

[216] G.S. 143B-426.40A.
[217] Article 5 of Chapter 159 of the General Statutes.
[218] G.S. 159-88.

obtained local legislation authorizing the levy of a room occupancy tax. A portion of those proceeds may be used for beach nourishment. Cities also receive a distribution of beer and wine excise taxes, electric franchise taxes, piped natural gas excise taxes, telecommunications taxes, and video programming taxes.

The second issue is the taxation and valuation of leasehold interests in exempt real property. North Carolina imposes a property tax on a leasehold interest in real property where the real property is exempt from property tax. The property tax on a leasehold interest in exempt real property applies when a unit of government leases property to a private business and when the payments under the lease are below the value of the interest in the real estate.[219] Most county assessors value these leasehold interests as the difference between the fair market value of the leasehold interest and the rent paid under the lease. For example, if the private tenant is paying market rate for the exempt real property owned by a local government, then the leasehold interest has no value because similar leases can be obtained at the same price. If the tenant is paying a bargain rate under the lease, the leasehold interest has value because a similar lease would cost more.

This topic received attention during this session because there were reports of inconsistent application of the law by different counties. However, there was not adequate time to address it during session. The Committee may report its findings, together with any recommended legislation, to the 2013 Regular Session of the General Assembly upon its convening.

GSC Technical Corrections/Other Changes.

Session Law	*Bill #*	*Sponsor*
S.L. 2012-194	**SB 847**	**Senator Hartsell**

AN ACT TO MAKE TECHNICAL CORRECTIONS TO THE GENERAL STATUTES, INCLUDING SPECIFICALLY AUTHORIZING THE REVISOR OF STATUTES TO PRINT DRAFTERS' COMMENTS TO THREE ACTS ENACTED IN 2011 IN WHICH THIS AUTHORIZATION WAS INADVERTENTLY OMITTED, AS RECOMMENDED BY THE GENERAL STATUTES COMMISSION, AND TO MAKE OTHER AMENDMENTS.

OVERVIEW: This act consists of technical corrections recommended by the General Statutes Commission and miscellaneous conforming and substantive changes. There are only two sections that are finance-related, one of which is a conforming change related to the cap on the motor fuel tax[220] and the other is an extension of the film credit. This Analysis addresses the extension of the film credit only.

FISCAL IMPACT: In recent years, the film credit has resulted in an annual loss to the General Fund of almost $36 million. The fiscal impact of the extension is estimated to cost $60 million and will occur in FY 2014-15. *(For a more complete fiscal analysis, see Finance Committee Highlights, 2012 Session, available online at www.ncleg.net.)*

EFFECTIVE DATE: This act became effective when the Governor signed it into law on July 17, 2012.

ANALYSIS: Section 79.10 of this act extends the expiration of the refundable film production tax credit from January 1, 2014, to January 1, 2015.

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[219] The only other form of intangible property subject to property tax is certain computer software.
[220] For an explanation of Section 61.2 of this act, see the Analysis for S.L. 2012-142.

During the 2012 Session, the General Assembly enacted S.L. 2012-36 (House Bill 1025)[221] which extended for one year a number of tax provisions that were scheduled to expire in 2013. The film credit was not included in that bill because it was not scheduled to expire until 2014. During hearings on House Bill 1025, the sponsors of the bill indicated that only those tax provisions scheduled to expire in 2013 were included since the General Assembly intends to undertake comprehensive tax modernization efforts in 2013 that may significantly alter the tax structure and potentially eliminate those tax credits altogether. [222]

In 2005, the General Assembly replaced the film industry development grant program with a refundable income tax credit calculated based on the qualifying expenses spent by a production company in connection with a production.[223] The credit amount is equal to 25% of the production company's qualifying expenses, which must exceed $250,000 and may not include any amount in excess of $1 million in compensation paid to an individual. The refundable film credit is capped at $20 million. The credit is claimed for the taxable year in which the production activities are completed. The credit is computed based on all of the taxpayer's qualifying expenses incurred with respect to the production, not just the qualifying expenses incurred during the taxable year. If the credit exceeds the amount of tax imposed for the taxable year reduced by the sum of all credits allowable, the Secretary must refund the excess to the taxpayer. A pass-through entity is considered a taxpayer for purposes of claiming this credit. In 2010, the General Assembly clarified[224] that purchases of cameras, film, props, building materials used in construction of sets, and chemicals/equipment used to develop and edit film do not fall within the scope of mill machinery for privilege tax purposes and are, therefore, subject to the general rate of sales tax beginning January 1, 2011.

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[221] This bill was a Revenue Laws Study Committee recommendation.

[222] However, during a Finance Committee meeting, the bill was amended to include an extension for the tax credits for rehabilitating historic structures and historic mill property, which were extended through the 2014 taxable year.

[223] Section 39.1 of S.L. 2005-276.

[224] S.L. 2010-147.

2011

TC: Eligibility: Indus Facil/Fix Uwharrie Com.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-3	**SB 76**	**Sen. Hartsell, Rucho, Clary**

AN ACT TO MAKE TECHNICAL AND CLARIFYING CHANGES TO THE INDUSTRIAL FACILITIES SALES TAX REFUND, A TECHNICAL CORRECTION TO THE MEMBERSHIP COUNT OF THE UWHARRIE COMMISSION, TO PROVIDE INTEREST ON OVERPAYMENT OF PROPERTY TAX, AND TO PROVIDE DELAY OF THE COLLECTION OF PROPERTY TAX PENDING APPEAL.

OVERVIEW: This act reenacts and amends the sales tax refunds for industrial facilities, provides for interest on overpayments of property tax, and delays the collection of property tax pending appeal. The remainder of this act does not affect North Carolina tax laws and is not discussed below.

FISCAL IMPACT: This act has no fiscal impact.

EFFECTIVE DATE: The section related to the sales tax refunds for industrial facilities is effective July 1, 2010, and applies to sales on or after that date. The section relating to interest on overpayments of property tax is effective for taxable years beginning on or after January 1, 2011.

ANALYSIS: This act makes changes in two unrelated areas. Section 1 of the act deals with the sales tax refund for industrial facilities. Section 3 of the act deals with property tax overpayments and appeals.

Sales Tax Refund for Industrial Facilities. – In 2010, the General Assembly expanded the list of industries allowed an annual sales and use tax refund to include paper-from-pulp manufacturing[1] and turbine manufacturing[2] as part of the Keeping NC Competitive Act.[3] The change was intended to become effective July 1, 2010, and apply to sales made on or after that date. During the same session, another act made technical changes to the sales and use tax refunds generally, but inadvertently failed to include the newly enacted refunds.[4] Statutory construction provides that when the General Assembly enacts two bills that amend the same existing general statute, the bill enacted last controls. Therefore, the refunds enacted in the Keeping NC Competitive Act (S.L. 2010-91) were, in effect, removed by S.L. 2010-166.

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[1] This incentive coincided with the announcement by Clearwater Paper Corporation that it would build a new tissue paper plant in Shelby, NC. The plant opened in June of 2011. According to a press release, the company has hired 100 local employees and plans to hire 150 more before the project is complete. When completed, the facility is expected to produce 10 million cases of bathroom tissue and paper towels annually.

[2] In March 2010, Siemens Energy announced plans to expand its Charlotte manufacturing plant for turbines and generators, investing over $100 million and creating over 800 jobs.

[3] Section 4 of S.L. 2010-91.

[4] S.L. 2010-166.

This act reenacts the sales tax refunds for paper-from-pulp manufacturing and turbine manufacturing enacted in S.L. 2010-91. It also makes the following changes to the refunds for industrial facilities:

- Amends the definition of "owner" to include lessees under a capital lease.
- Deletes the defined term "strategic partner." This term was used only in the refund for computer manufacturing facility, which has been repealed.
- Removes additional reference to computer manufacturing facilities.
- Clarifies the minimum investment requirement for the refunds can be met by funds invested directly or indirectly through a related entity.

Property Tax Overpayments and Appeals. – Section 3 of this act provides interest on overpayments and suspension of the enforcement proceedings for property valuations that have been appealed to the county boards of equalization and review.

Individuals may appeal property tax valuations to the county board of equalization and review. The State Property Tax Commission hears appeals from the local boards of equalization and review. If the Property Tax Commission reduces the value of the property, or removes the property from taxation, the taxpayer receives interest on any overpayment of taxes. The tax collector may not enforce collection of the tax while the appeal to the Property Tax Commission is pending, but interest will accrue if the taxes are not timely paid. Under prior law, there were not corresponding provisions for appeals pending at county boards of equalization and review. Section 3 establishes similar provisions at the county level. If the county board of equalization and review reduces the value of the property, or removes the property from taxation, the taxpayer receives interest on any overpayment of taxes. The interest for overpayments is the same as the interest charged for delinquent taxes. The tax collector may not enforce collection of the taxes while the appeal to the board is pending, but interest will accrue if the tax is not timely paid.

Clarify Refunds of Tax Overpayments.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-4	**SB 97**	**Sen. Rucho, Hartsell, Daniel**

AN ACT TO CLARIFY WHEN THE DEPARTMENT OF REVENUE IS REQUIRED TO INITIATE A REFUND OF AN OVERPAYMENT OF TAX AND TO AUTHORIZE THE ISSUANCE OF REFUNDS OF OVERPAYMENTS THAT HAVE BEEN IDENTIFIED BY THE DEPARTMENT CONSISTENT WITH THIS CLARIFICATION.

OVERVIEW: This act clarifies when the Department of Revenue is required to initiate a refund of an overpayment of tax and directs the Department to issue refunds for overpayments that have been discovered within the statute of limitations consistent with this clarification.

FISCAL IMPACT: This act has no fiscal impact.

EFFECTIVE DATE: This act became effective when the Governor signed it into law on March 9, 2011.

ANALYSIS: Prior to the effective date of this act, the law provided two methods for obtaining a refund of tax from the Department of Revenue. If a taxpayer was aware that he or she had made an overpayment, then the taxpayer could request a refund by filing an amended return or by filing a claim for refund. If a taxpayer was not aware of an overpayment, the Department was required to initiate the refund process if, within the statute of limitations period, it became aware of or "found" the overpayment. Specifically, the Department was required to initiate a refund of an overpayment of tax when the Department processed a return and found all of the following:

1. The statute of limitations[5] for obtaining a refund has not expired.
2. The amount shown due on the return is not correct.
3. The correction of the amount due shows that the taxpayer has overpaid the tax.

Prior law did not specify what constitutes "finding" or discovering an overpayment for purposes of satisfying the statute of limitations. In other words, it did not identify what action must take place by the Department before the statute of limitations expires.

During 2009 and 2010, the Department was engaged in working through a backlog of returns that were flagged for review by the Department's computer system, some dating as far back as 1996. By December of 2010, the vast majority of returns had been reviewed and many refunds were issued. However, at the beginning of 2011, approximately 7,000 returns remained in which an overpayment was made but a refund was not issued because the Department believed it needed clarification from the General Assembly about the application of the then existing law. Those overpayments totaled a little over $2 million plus interest.

The Revenue Laws Study Committee examined the issue during the interim following the conclusion of the 2010 Regular Session. The Committee heard differing opinions about the interpretation of the law and its application to overpayments. The Secretary of Revenue testified that the Department had been advised by the Attorney General's office that the existing law required the Department to issue a refund of an overpayment only if the overpayment was verified by a Departmental employee within the statute of limitations period. Under this interpretation, a taxpayer's receipt of a refund is dependent on the Department's ability to timely review the return, which can vary depending on its workload and resources.

An alternative interpretation of the then existing law was that the Department is required to issue a refund of an overpayment if the return is flagged by the Department's computer system within the statute of limitations. The Department may need to verify the existence of an overpayment by manual review of a flagged return, but the manual review need not occur within the statute of limitations. Because returns are processed by the computer system almost immediately after they are filed, this interpretation assures that taxpayers will eventually get a refund if an overpayment was made.

Despite a finding by the Revenue Laws Study Committee that the existing law could reasonably be interpreted to authorize the Department to release the remaining 7,000 refunds because, although they had not been manually reviewed within the statute of limitations, they had been flagged by the Department's computer system within the statute of limitations thereby putting the Department on notice, the Department sought clarifying legislation.

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[5] The general statute of limitations for obtaining a refund is the later of three years after the due date of the return or two years after the payment of tax.

The act clarifies when the discovery of an overpayment occurs, triggering the Department of Revenue's obligation to issue a refund. Under the act, discovery occurs in any of the following circumstances:

1. When the automated processing of a return indicates the return requires further review.
2. When a review of a return by an employee indicates an overpayment.
3. When an audit of a taxpayer by an employee indicates an overpayment.

If the Department's computer system flags a return for further review, the Department must verify that an overpayment exists before issuing a refund because the automated flagging does not always indicate the precise nature of an error on a return. However, this act clarifies that the verification need not occur within the statute of limitations period. The flagging of the return is sufficient to put the Department on notice that a refund may be due for purposes of satisfying the statute of limitations.

The act also directed the Department to issue refunds of overpayments that have been discovered within the statute of limitations in a manner consistent with the clarification set out by the act. After passage of this act, the refunds were issued in April of 2011 with 5% interest.

IRC Update.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-5, as amended by S.L. 2011-330	**HB 124**	**Rep. Howard, Brubaker, Starnes, Setzer**

AN ACT TO UPDATE THE REFERENCE TO THE INTERNAL REVENUE CODE

OVERVIEW: This act updates the reference to the Internal Revenue Code used in defining and determining certain State tax provisions from May 1, 2010, to January 1, 2011. The act incorporates many, but not all, of the tax provisions contained in the federal Small Business Jobs Act of 2010 and the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010.

It conforms to the Code by extending for an additional two years various individual and business tax deductions that expired in 2010, such as the tax deduction for higher education expenses and the $250 tax deduction for teacher's classroom supplies.

It decouples from the bonus depreciation provision, but maintains the same basis in the property for federal and State tax purposes, by requiring an 85% addback of any accelerated depreciation a taxpayer claimed on the federal return for taxable years 2010[6] through 2012 and a corresponding deduction of 20% of this amount over the next five tax years.

[6] The effective date of the federal 100% bonus depreciation provision applied to property placed in service after September 8, 2010, *in taxable years ending after such date*. This effective date means the bonus depreciation provision may be taken in the 2009 taxable year if a taxpayer had a taxable year ending after September 8, 2010, and before December 31, 2010. Therefore, the bill would provide that the adjustments needed to decouple from this provision may be reflected on a taxpayer's 2009 tax year return.

It conforms to some of the section 179 changes, and decouples from others. It maintains the current section 179 expense deduction limit and cap through 2011 and conforms to the federal section 179 expense deduction limit and cap for 2012. It conforms to the expanded definition of qualifying property for taxable years 2010 and 2011. It decouples from the additional section 179 expense deduction by requiring an 85% addback of the additional expensing taken under federal law and providing a corresponding deduction of 20% of this amount over the next five tax years.

FISCAL IMPACT: With the exception of the estate tax, the act's impact on General Fund availability is minimal. Conformity to the higher estate tax exclusion amount of $5 million, and effectively $10 million for married couples, will reduce General Fund revenues by $59 million in Fiscal Year 2011-12 and by $79 million in Fiscal Year 2012-13. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2011 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective when the Governor signed it into law on March 17, 2011.[7] Several of the tax provisions contained in the federal acts became effective retroactively. Article I, Sec. 16 of the North Carolina Constitution prevents North Carolina from enacting a law that retroactively increases a person's tax liability. Therefore, any amendments to the Internal Revenue Code enacted after May 1, 2010 that increase North Carolina taxable income for the 2010 taxable year or impose an estate tax on the estate of a decedent dying in calendar year 2010 become effective for taxable years beginning on or after January 1, 2011.

ANALYSIS: North Carolina's tax law tracks many provisions of the federal Internal Revenue Code by reference to the Code.[8] The General Assembly determines each year whether to update its reference to the Code.[9] Updating the reference makes recent amendments to the Code applicable to the State to the extent that State law previously tracked 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. Maintaining conformity with federal tax law simplifies tax reporting because a taxpayer will not need to account for differing federal and State treatment of the same asset.

This act updates the reference to the Internal Revenue Code used in defining and determining certain State tax provisions from May 1, 2010, to January 1, 2011. The act incorporates many, but not all, of the tax provisions contained in the Small Business Jobs Act of 2010, enacted

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[7] S.L. 2011-330, Section 11, clarified that the act applies to the estates of decedents dying on or after January 1, 2011. The Department of Revenue requested the clarifying change so there would be no confusion as to the applicable exclusion amount for the estates of decedents dying on or after January 1, 2011, and before March 17, 2011.

[8] 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.

[9] 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."

September 27, 2010, as P. L. 111-240 (2010 Jobs Act), and the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act, enacted December 17, 2010, as P. L. 111-312 (2010 Tax Relief Act).

The 2010 Jobs Act enhances existing business tax incentives and partially offsets this revenue loss with changes that are expected to increase revenue. The incentives in the 2010 Jobs Act are not limited to small businesses, and the accelerated deduction for depreciation represents a major benefit to large businesses. The 2010 Tax Relief Act boosts some of the business tax incentives in the 2010 Jobs Act and extends for two years the Bush-era individual and business tax incentives, included in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA)[10]

Extension and Expansion of Bonus Depreciation for 2010, 2011, and 2012. – Businesses may depreciate the cost of a new asset[11] over a period of time, usually five to 15 years. Bonus depreciation allows a business to claim more of a deduction up front and spread the remaining deduction amount over the normal depreciation schedule. The federal Economic Stimulus Act of 2008[12] provided a 50% first-year bonus depreciation for qualified property acquired and placed in service in 2008. The federal American Recovery and Reinvestment Act of 2009 extended the 50% bonus depreciation provided to qualified property for an additional year through 2009.

The 2010 Jobs Act extended retroactively the bonus depreciation for 2010 to property acquired and placed in service in 2010.[13] The 2010 Tax Relief Act increased the 50% bonus depreciation extended under the 2010 Jobs Act to 100% for property acquired and placed in service after September 8, 2010, and before January 1, 2012. It also provided 50% bonus depreciation for qualified property placed in service after December 31, 2012, and before January 1, 2013. Under the 2010 Jobs Act, the bonus depreciation would have expired for the 2012 taxable year. Under the 2010 Tax Relief Act, the bonus deprecation expires for the 2013 taxable year.

This act decouples from the bonus depreciation provisions for 2010, 2011, and 2012[14] in the same manner as it has decoupled from them in 2008 and 2009: a taxpayer may deduct the same amount of an asset's basis under State law as under federal law, it is just that the timing of the deduction differs. Under State tax law, a taxpayer must add back 85% of the accelerated depreciation amount[15] in the year that it is claimed for federal purposes. Then, in subsequent tax years, the taxpayer may deduct from federal taxable income the total amount

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[10] Most of the tax provisions in EGTRRA were scheduled to expire in 2010 or 2011 and revert to the provisions as they existed in 2001.

[11] One important difference between bonus depreciation and section 179 expensing is that bonus depreciation applies only to new equipment, while section 179 expensing may apply to new and used equipment.

[12] Congress has authorized bonus depreciation several times to encourage business investment, specifically after September 11, 2001. The Jobs Creation and Worker Assistance Act of 2002 provided a 30% bonus depreciation allowance. The Jobs and Growth Tax Relief Reconciliation Act of 2003 extended the sunset and increased the amount to 50%.

[13] The property may be placed in service during 2011 for property with a recovery period of 10 years or longer and for transportation property (i.e., tangible personal property used to transport people or property).

[14] The cost to conform to the bonus depreciation provision would have been approximately $460 million. As of February 16, 2011, it appears 15 of 43 states conformed to this provision in some form while the remaining 28 states did not.

[15] The accelerated depreciation amount for property placed in service in 2008 is 50%.

of the add-back, divided into five equal installments. This adjustment means that for State tax purposes, a taxpayer may deduct a greater depreciation amount in the outlying tax years, which will be the normal depreciation amount plus 20% of the accelerated depreciation amount the taxpayer had to add back.

Under the 2010 Tax Relief Act, the 100% bonus depreciation applied to property placed in service after September 8, 2010, *in taxable years ending after such date*. This effective date means the bonus depreciation provision may be taken in the 2009 taxable year if a taxpayer had a taxable year ending after September 8, 2010, and before December 31, 2010. Therefore, the act provides that the adjustments needed to decouple from this provision may be reflected on a taxpayer's 2009 tax year return.

Enhanced Section 179 Expensing for 2010, 2011, and 2012. – Section 179 of the Code allows the expensing of the purchase price of some business assets[16] in the year of purchase rather than taking depreciation[17] throughout the life of the asset. In other words, expensing trades a smaller yearly deduction over time for a larger deduction in year one. Section 179 is commonly thought to apply to small businesses because of its maximum deduction and investment limits. Prior to the Emergency Economic Stabilization Act of 2008 (EESA), the deduction limit for section 179 expensing was $128,000[18] of the cost of the property with a dollar-for-dollar phaseout of this amount whenever the total cost of qualifying property placed in service that year exceeded $510,000.[19] EESA increased the deduction limit from $128,000 to $250,000 with a phaseout at $800,000 for the 2008 tax year. The American Recovery and Reinvestment Tax Act of 2009 (ARRTA) extended the temporary increase through 2009. The federal Hiring Incentives to Restore Employment Act of 2010 extended the 2008 and 2009 increase through 2010. The limits were scheduled to revert to the prior levels of $25,000 and $200,000 in taxable year 2011.[20]

The 2010 Jobs Act not only delayed the reversion to the prior levels until the 2012 taxable year, it also increased the section 179 expensing deduction for tax years 2010 and 2011 from $250,000 and $500,000 to $800,000 and $2 million. The enhancements made by the 2010 Jobs Act are the most expansive ever enacted. The 'small business' label associated with the section 179 deduction does not reflect the true scope of the deduction as enhanced by the 2010 Jobs Act since it currently impacts businesses of many sizes. In addition to the expansion of the limits, the 2010 Jobs Act broadened the definition of qualified property to include qualified leasehold improvement property, qualified restaurant property, qualified retail improvement property, and computer software.[21] The enhancements made by the 2010 Jobs Act are set to expire for the 2012 taxable year.

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[16] The business asset must be newly purchased tangible personal property that is used more than 50% for business purposes and is eligible to be depreciated under the Code. The newly purchased property may be new or used equipment.

[17] Generally, taxpayers take the Section 179 expensing deduction first and claim Section 168(k) depreciation on any remaining basis.

[18] Prior to the EESA, the dollar limits would have been $125,000 with a phase-out beginning at $500,000; both amounts would have been indexed for inflation resulting in the limits of $128,000 and $510,000.

[19] For example, if the taxpayer placed in service during the taxable year one or more items of qualifying property totaling $520,000, the amount that could be expensed under section 179 would be $118,000 -- $128,000 less $10,000, which is the excess of $520,000 over $510,000.

[20] North Carolina conformed to these changes.

[21] Qualified real property is limited to a maximum deduction of $250,000.

The 2010 Tax Relief Act does not continue the expansion of the types of property that may qualify for the deduction beyond the 2011 taxable year, but it does increase the limits for the 2012 taxable year from $25,000 and $200,000 to $125,000 and $500,000. Under the 2010 Tax Relief Act, the deduction limits are set to revert to their prior levels of $25,000 and $200,000 in 2013.

This act conforms to the expanded definition of qualified property; but it maintains the 2010 deduction limits of $250,000 and $800,000 for taxable years 2010 and 2011; and it decouples from the enhanced limits of $500,000 and $2,000,000 for taxable years 2010 and 2011.[22] The act provides that the property's basis remains the same for federal and State purposes by treating the difference in the same manner as State tax law has historically treated the bonus depreciation: A taxpayer must addback 85% of the additional expensing taken under federal law in 2010 and 2011 and deduct 20% of this amount over the succeeding five years. The act conforms to the expensing limits of $125,000 and $500,000 for the taxable year 2012 and, like federal law, reverts to the prior expense limits of $25,000 and $200,000 for the taxable year 2013.

Estate Tax for 2010 - 2012. – EGTRRA gradually reduced the federal estate tax over a period of years and abolished it for decedents dying in 2010. During the year of its repeal, the basis of property passing through an estate was determined by the modified carryover basis rules under EGTRRA. EGTRRA also repealed the state estate tax credit for decedents dying on or after 2004 and replaced the credit with a deduction. The estate tax was scheduled to revert to the 2001 law in 2011: the 2001 maximum estate tax rate of 55% and a $1 million applicable exclusion amount.

The 2010 Tax Relief Act revived the estate tax retroactively for decedents dying on or after January 1, 2010; the revival of the estate tax allowed property passing through the estate to acquire a stepped-up basis. The maximum federal estate tax rate is 35% with an applicable exclusion amount of $5 million. The 2010 Tax Relief Act also provided for portability between spouses of the exclusion amount. This portability means that any unused exclusion amount by one spouse is available to the surviving spouse, effectively allowing a married couple to exclude up to $10 million from estate tax.[23] The new estate tax law is scheduled to sunset on December 31, 2012, to the pre-EGTRRA amounts. The 2010 Tax Relief Act gives the estates of decedents dying in 2010 the option to pay no estate tax and assume the modified carryover basis in the property.

North Carolina imposes an estate tax on the estate of a decedent when a federal estate tax is imposed on the estate.[24] By virtue of this language, the federal and state exclusion amounts are the same. The amount of the State's estate tax is the amount of the credit allowed on the federal estate tax return for state estate tax paid, as the federal law provided in 2001.[25]

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[22] Full conformity to the section 179 expense deduction would have reduced General Fund revenue by approximately $97 million. As of February 16, 2011, it appears 24 of 43 states conformed to this provision in some form while the remaining 19 states did not.

[23] The portability election is set to sunset December 31, 2012. Therefore the utility of the portability election is limited to situations where both spouses die within the two-year term (2011 and 2012).

[24] North Carolina repealed its inheritance tax in 1998 and replaced it with an estate tax that was equivalent to the federal state estate tax credit allowed on a federal estate tax return. This type of state estate tax was known as a "pick up" tax because it picked up for the state the amount of federal estate tax that would otherwise be paid to the federal government.

[25] When Congress phased out the state estate tax credit, beginning in 2002, North Carolina enacted legislation not to conform to the phaseout of the credit. In other words, North Carolina began tying the

Since the federal estate tax did not exist in 2010, North Carolina's estate tax was repealed for 2010. With the revival of the federal estate tax in 2011, North Carolina's estate tax is revived for the estates of decedents dying on or after January 1, 2011.[26] Unlike Congress, North Carolina cannot tax retroactively[27] the estates of decedents dying on or after January 1, 2010, and before January 1, 2011. However, by conforming to the definition of federal taxable income for income tax purposes, the basis of any property passing through an estate has the same basis for both federal and State tax purposes.

Business Tax Extenders for 2010 and 2011. – The 2010 Tax Relief Act extended many of the tax incentives enacted in EGTRRA for two years. The business tax incentives included enhanced deduction and expensing items, charitable deductions, and tax credits. North Carolina conformed to these incentives in 2002[28] this act conforms to these extensions.

The 2010 Tax Relief Act extended the following business tax incentives that were set to expire for the 2010 taxable year for the 2010 and 2011 taxable years:

15-year recovery period for qualified leasehold improvements, restaurant building and improvements, and retail improvements.

Seven-year recovery period for motor sports entertainment costs recovery.

Expensing election for certain film and television production costs.

Brownfields remediation expensing.

The 2010 Tax Relief Act extended the Work Opportunity Tax Credit (WOTC) to include individuals who begin employment after August 31, 2011, and before January 1, 2012. The WOTC is equal to 40% of up to $6,000 of the targeted employee's qualified first-year wages. North Carolina's WOTC is equal to 6% of the federal WOTC for wages paid for positions located in this State. The federal WOTC was scheduled to expire September 1, 2011.

The 2010 Tax Relief Act extended the following charitable incentives for taxable years 2010 and 2011:

Deduction for contributions of food inventory.

Deduction for contributions by C corporations of books to public schools.

Deduction for corporate contributions of computer equipment for educational purposes.

Basis adjustment to stock of S corporations making charitable contributions of property.

Individual Income Tax Extenders for 2010, 2011, and 2012. – The 2010 Tax Relief Act extended many of the Bush-era individual tax incentives included in the EGTRRA for two years. Some of the tax incentives expired in 2010 and others were scheduled to expire in 2011. North Carolina conformed to these incentives in 2002[29] this act conforms to these extensions.

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amount of the State estate tax owed to the federal credit as it existed in 2001 rather than as it currently exists. Georgia, South Carolina, and Tennessee have not had an estate tax since January 1, 2005, because their estate tax equals the amount of the state estate tax credit allowed on the federal estate tax return. Virginia repealed its estate tax, effective July 1, 2007.

[26] North Carolina's estate tax would have been revised in 2011 based upon the Code as written on May 1, 2010.

[27] Article I, Sec. 16 of the North Carolina Constitution.

[28] S.L. 2002-126.

[29] S.L. 2002-126.

The following three individual income tax incentives were scheduled to expire in 2010, but the 2010 Tax Relief Act extended them retroactively for the 2010 tax year and the 2011 tax year:

Tax deduction for higher education tuition expenses

Up to $250 deduction for teacher's classroom expenses

Charitable contribution of IRA proceeds

The following individual income tax incentives were scheduled to expire in 2011, but 2010 Tax Relief Act extended the incentives for the 2011 and 2012 taxable years:

No limitation on itemized deductions. Section 68 of the Code, first added in 1990, established an overall limitation on itemized deductions. This limitation was gradually repealed starting in 2006, with the phase-out complete in taxable year 2010. The limitation was scheduled to revert in full in 2011. The 2010 Tax Relief Act extended the complete repeal of the limitation for 2011 and 2012.

Enhancements to the earned income tax credit (EITC). The EITC is a refundable tax credit that varies depending on the number of the taxpayer's qualifying children. North Carolina's EITC is equal to 5% of the federal credit amount. EGTRRA increased the credit amount from 40% to 45% of a family's first $12,570 of earned income for families with three or more children and the beginning point of the phase-out range for married coupled filing a joint return by $1,880. The enhancements were set to expire for the 2011 taxable year. The 2010 Tax Relief Act extended the enhancements through the 2011 and 2012 taxable years.

Enhancements to the adoption tax credit. EGTRRA increased the dollar limitation for the credit and the income exclusion for employer-paid expenses to $10,000, indexed for inflation. The Patient Protection and Affordable Care Act increased the credit and exclusion by another $1,000 for 2010 and 2011. The credit cap was scheduled to return to $5,000[30] for taxable years beginning on or after January 1, 2012. North Carolina's adoption tax credit is equal to 50% of the federal credit amount. The 2010 Tax Relief Act extended the enhancements made by EGTRRA for one year. Under the Act, the credit caps will revert to their prior levels in taxable year 2013.

Deductibility of mortgage insurance premiums. Mortgage insurance premiums became deductible in 2007. The insurance must be in connection with home acquisition debt for a first or second home. The deduction is subject to phase-out based on a taxpayer's income. The deductibility of mortgage insurance premiums was set to expire for taxable year 2011. The 2010 Tax Relief Act extended the deduction for one more year, through taxable year 2011

Educational assistance exclusion. EGTRRA allowed employees to exclude up to $5,250 in employer-provided education assistance from income and employment taxes. The exclusion was set to expire for taxable year 2011. The 2010 Tax Relief Act extended the exclusion for taxable years 2011 and 2012.

Student loan interest deduction. The student loan interest deduction is a deduction from gross income used to determine a taxpayer's adjusted gross income (AGI). The deduction is subject to a phase-out based on the taxpayer's AGI. EGTRRA eliminated the rule that the deduction only applies to payments made during the first 60 months that interest payments were required, and it increased significantly the phaseout amounts. These changes were set to

[30]The limit is $6,000 for a special needs child.

expire in 2011, but the 2010 Tax Relief Act extended the changes for taxable years 2011 and 2012.

Coverdale education savings accounts. Coverdale education savings accounts allow a taxpayer to make nondeductible contributions and to withdraw the proceeds tax-free if they are used towards educational expenses. EGTRRA increased the amount that may be contributed to an account from $500 to $2,000, and it made elementary and secondary school expenses qualified expenses. The enhancements were set to expire for the 2011 taxable year. The 2010 Tax Relief Act extended the enhancements for taxable years 2011 and 2012.

Qualified scholarships. Qualified scholarships may be excluded from taxable income. EGTRRA provided that the national Health Services Corps Scholarship Program and the Armed Forces Scholarship Program are qualified scholarships for exclusion for income purposes. These scholarships were scheduled to be included in a recipient's income in taxable year 2011. The 2010 Tax Relief Act extended the income exclusion for taxable years 2011 and 2012.

Miscellaneous Business Incentives. -- The 2010 Jobs Act provided several tax incentives for businesses. This act conforms to those incentives.

Increase in amount allowed as a deduction for start-up expenditures. The Code allows up to $5,000 of start-up expenses to be deducted. The deduction is reduced by the amount of start-up costs that exceed $50,000. The 2010 Jobs Act increased the deduction to $10,000 for start-up and organization expenses of the taxpayer's trade or business in 2011 and increased the phase-out threshold to $60,000.

Modification to exclusion for gain from certain small business stock. Fifty percent of the gain realized on qualified small business stock may be excluded from income. To qualify, the stock must be purchased at its original issue and the aggregate gross assets of the issuing corporation may not exceed $50 million and at least 80% of the value of its assets must be used in the active conduct of one or more trades or businesses. The exclusion is capped at the greater of 10 times the taxpayer's basis in the stock or $10 million. ARRTA temporarily increased from 50% to 75% the exclusion for qualified small business stock sold by an individual. The increased exclusion percentage is applicable to stock acquired after February 17, 2009, and before January 1, 2011. North Carolina conformed to ARRTA's temporary increase of the exclusion. The 2010 Jobs Act increased the exclusion percentage to 100% for stock acquired after September 27, 2010, and before January 1, 2011.

Provisions in the 2010 Jobs Act Designed to Increase Revenue. – The 2010 Jobs Act contained provisions to increase revenues. The provisions projected to raise the most revenue were related to higher federal tax penalty provisions. These provisions would not apply to North Carolina and would not increase any revenues payable to North Carolina. The Act also contained some retirement-friendly provisions that, if chosen by the taxpayer, would encourage up-front distributions that would be taxable. This act conforms to these changes.

Deduction for health insurance costs in computing self-employment taxes. The 2010 Jobs Act allows self-employed individuals to deduct the cost of health insurance for the individual and immediate family to determine income subject to federal self-employment taxes. Health insurance costs were already deductible for regular income tax purposes. The reduction in self-employment taxes affects North Carolina taxable income because self-employment taxes were deductible in determining State taxable income. Self-employed taxpayers with

health insurance costs will have larger State taxable incomes because less self-employment taxes were imposed and deducted at the federal level.

Allow participants in governmental 457 plans to treat elective deferrals as Roth contributions. The 2010 Jobs Act gives participants the option to move retirement savings from government 457(b) plans to Roth accounts starting in 2011. The conversion will be taxable while the earnings and distributions from Roth accounts are generally tax-free.

Allow rollovers from elective deferral plans to Roth designated accounts. The 2010 Jobs Act allows retirement plans to offer participants the option starting September 27, 2010 to rollover distributions into Roth accounts within the same retirement plan. The rollover will be taxable while the earnings and distributions from the Roth account are generally tax-free.

Permit partial annuitization of a nonqualified annuity contract. The 2010 Jobs Act allows the owner of an annuity contract to begin receiving benefits based on a portion of the value of the annuity and leaving the balance of the annuity to accumulate earnings tax free. This option starts in 2011.

Source rules for income on guarantees. The 2010 Jobs Act clarifies the federal tax treatment of guarantee fees as income sourced to the United States if connected to the United States by a domestic payer or by the conduct of a trade or business in the United States.

Business Entity Changes.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-9	**HB 123**	**Rep. Howard, Brubaker, Luebke, Hill**

AN ACT TO REVISE THE BUSINESS ENTITY OWNERSHIP REQUIREMENTS OF LAND AT PRESENT-USE VALUE.

OVERVIEW: This act makes changes to the business entity ownership requirements for qualification of land at its present-use value for property tax purposes, so that the requirements are met when the current owner of the land shares members in common with the prior owner of the land. This act was a recommendation of the Revenue Laws Study Committee.

FISCAL IMPACT: This act has no General Fund impact.

EFFECTIVE DATE: This act becomes effective for taxable years beginning on or after July 1, 2011. However, applications filed beyond the listing period (January 1-January 31) will be accepted up to and through September 1, 2011, so that an owner may benefit from the property tax relief during the July 1, 2011 tax year.

ANALYSIS: Since 1973, farmland[31] has been appraised and assessed at its present-use value (PUV) as opposed to fair market value for property tax purposes if the farmland meets certain ownership, size, and use requirements. Farmland owned by a business entity meets the ownership requirements if the land was owned by the business entity or one of its members for the four years immediately preceding January 1 of the year for which the benefit is claimed.

This act allows the business entity ownership requirements to be satisfied when the business entity that currently owns the farmland shares one or more members in common with the business entity

[31] Agricultural land, horticultural land, and forestland.

that previously owned the farmland. For example, if one or more partners of the partnership that currently owns the farmland are the same partners of the partnership that previously owned the farmland, the ownership requirement is met.

This act was a recommendation of the Revenue Laws Study Committee, which examined this issue after several counties denied PUV status to farmland owned as described below based upon the language in G.S. 105-277.3(b1). In this example, the farmland was not owned by its current owner, ABC Partnership, for four years immediately preceding the application, nor was the land owned by a partner of ABC Partnership.

> Farmland owned by ABC Partnership for past four years applies for PUV status.
>
> The partners of ABC Partnership are Tom, Dick, and Harry.
>
> The previous owner of the farmland was XYZ Partnership.
>
> XYZ Partnership shares one or more partners in common with the current owner ABC Partnership.

Prior to 2008, the members of the business entity had to be individuals. In 2008, the Revenue Laws Study Committee proposed legislation to broaden the ownership requirements so that farmland could be owned by a business entity whose membership includes modern estate planning vehicles such as a family limited partnership, a family limited liability company, or a trust.[32] S.L. 2008-146 alleviated problems tax assessors were having with recognizing these types of ownership. Now, for example, if the farmland is owned by a business entity, the members of the business entity are no longer restricted to individuals but may include trusts and other business entities. The 2008 changes to the PUV statutes focused on problems the tax assessors were having with recognizing types of ownership. Ownership is determined on the basis of the name on the deed but does not always consider real parties in interest.

Reform UI Tax Structure/Expedite Analysis.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-10	**SB 99**	**Sen. Clary, Rucho, Hartsell**

AN ACT TO EXPEDITE THE ANALYSIS OF THE TAX STRUCTURE FOR UNEMPLOYMENT INSURANCE IN NORTH CAROLINA GIVEN THE SUBSTANTIAL NEGATIVE BALANCE IN THE STATE'S UNEMPLOYMENT INSURANCE TRUST FUND AND THE SUBSTANTIAL FEDERAL LOAN BALANCE OWED BY THE STATE FOR PAYMENT OF UNEMPLOYMENT INSURANCE BENEFITS.

OVERVIEW: This act authorizes the Department of Commerce to hire a consultant to analyze the State's unemployment insurance (UI) tax structure without adhering to the State's purchase and contract provisions.

FISCAL IMPACT: The act does not appropriate any funds to the Department of Commerce for the contract. The act states that the Department may seek and accept non-State funds, grants, and in-kind contributions to pay for the analysis as well as use funds available within

[32] When the membership of a business entity includes a business entity or trust, then the individual members of the business entity and the individual beneficiaries of the trust are deemed to be indirect members of the qualified business entity.

the Employment Security Commission, including State and federal funds that may be used for this purpose. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2011 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective when the Governor signed it into law on March 25, 2011.

ANALYSIS: The act directs the Department of Commerce to contract with a consultant to conduct a thorough analysis of the State's UI tax structure and it exempts the Department from purchase and contract requirements of Article 3C as they relate to this contract. The Department must provide periodic updates on the progress of the analysis and it must report the findings and recommendations of the analysis to the General Assembly within 45 days after the analysis is complete. The report must include recommendations on any tax structure changes and financial options the General Assembly may need to consider that addresses the servicing of the State's debt incurred to pay unemployment insurance benefits.

Article 3C of Chapter 143 directs the Department of Administration to ensure that consultant contracts be let to other agencies of the State if there is an agency that can reasonably perform the service, and if there is not an agency that can reasonably perform the consulting service, that a sufficient number of sources for the contract be solicited through competitive proposals. This act allows the Department of Commerce to use the contractor of its choice without soliciting competitive bids, and regardless of whether another State agency could reasonable perform the service. Through House and Senate Finance Committee discussions, members learned that South Carolina had undertaken a similar study prepared by *The Lucas Group,* a consultant in Boston, Massachusetts. The Department would not say who it would choose to conduct the study.[33]

The General Assembly made substantial changes in the State's UI tax structure in the 1990s.[34] There have been no legislative changes made to the rate structure since 1999. The current State UI tax rates range from 0% to 6.84%.[35] The standard beginning tax rate is 1.2%. The average UI tax rate for 2011 is 1.688%. The average UI tax rate for 2010 was 1.427%. The revenue generated from the tax is credited to the State's Unemployment Trust Fund[36] to pay benefits to people who lost their job through no fault of their own.

If the amount of revenue in the State's Unemployment Insurance Trust Fund is insufficient to make the necessary benefit payments to claimants, the federal government loans money to the State. The State received a loan from the federal government in February 2009. The current loan

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[33] It would cost between $200,000 and $300,000 to contract with *The Lucas Group*.

[34] The General Assembly reduced the UT tax contribution rate in 1993, 1994, 1995, and 1996. The UI tax rate automatically adjusts downward whenever the UI Trust Fund balance reaches $800 million. The Trust Fund balance has not exceeded $800 million since 2001. The last positive Trust Fund balance was in 2008 at $414 million.

[35] All states' UI rate structures use a system of experience rating by which individual employers' contribution rates are varied on the basis of their experience with the risk of unemployment. An employer may qualify for the 0% tax rate if no unemployment insurance benefits have been paid to employees after five years.

[36] Unemployment tax contributions are paid by employers on a quarterly basis and deposited into the State Unemployment Insurance Trust Fund. After deducting any refunds payable from the Fund, the money is deposited with the Secretary of the Treasury of the United States to the credit of this State's account in the Unemployment Trust Fund. Funds in the State's account earn interest that is also credited to the account. As money in the State's account is needed to pay benefits, it is transferred to the State and credited to the benefits account of the State's Unemployment Insurance Fund.

balance is $2.6 billion. Interest began accruing on the loan in January 2011. The first interest payment is due September 30, 2011.[37] The necessary funds are available in the State's reserve account to make this interest payment.

In addition to the State UI tax, employers pay a federal payroll tax. The federal payroll tax (FUTA) on employers is 6.2% on a taxable wage base of $7,000.[38] Employers in states that are in compliance with federal regulations receive a 5.4% credit on their FUTA. This tax credit percentage is reduced by 0.3% annually on states with a federal loan balance outstanding for two consecutive Januarys. January 2012 will mark the second consecutive January North Carolina has a federal loan balance outstanding. To avoid a 0.3% reduction in the FUTA credit, the entire balance of the loan must be paid by November 10, 2011.[39] The 0.3% increase would effectively increase employers FUTA from 0.08% to 1.1%; this increase equates to $21 per employee.[40]

Repeal Land Tansfer Tax.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-18	**HB 92**	**Rep. Howard, Starnes, Brawley, Jordan**

AN ACT TO REPEAL THE LAND TRANSFER TAX.

OVERVIEW: This act repeals the authority granted to counties in 2007 to levy, upon approval of voters in the county, a tax on the sale of real property at the rate of up to 0.4% of the value of the property.

FISCAL IMPACT: This act has no fiscal impact because none of the counties implemented the levy.

EFFECTIVE DATE: This act became effective when the Governor signed it into law on March 31, 2011.

ANALYSIS: This act repeals the County Land Transfer Tax Act, which authorized counties to levy, with voter approval, a tax on the transfer of real property at the rate of up to 0.4% of the consideration or the value of the property interest, whichever is greater.

In 2007, legislation was enacted authorizing a board of county commissioners, by resolution and after 10 days public notice, to levy a local land transfer tax on instruments conveying interests in real property located in the county, up to a rate of 0.4%, in increments of 0.1%.[41] The imposition of the tax is subject to voter approval in a public referendum. The tax is payable

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[37] President Obama's budget proposal includes waiving the interest payment due September 30, 2011. Congress has not acted on this provision as of August 1, 2011.

[38] The federal taxable wage base has not been increased since 1983. The taxable wage base in NC is $19,700. This amount is indexed annually. The taxable wage base in other states ranges from $7,000 to $37,300.

[39] President Obama's budget proposal includes suspending the FUTA tax increase. Congress has not acted on this issue as of August 1, 2011.

[40] The revenue collected from the FUTA rate increase would be applied to the State's principal balance or it would lessen the amount of funds the State needs to borrow if the State is still a borrowing State at that time.

[41] Section 31.17 of S.L. 2007-323.

by the transferor of the property. The tax is in addition to the excise stamp tax on conveyances of land, and land exempt from the stamp tax is also exempt from the land transfer tax.[42] This tax was one of two local financing options enacted during the 2007 session. As an alternative to the land transfer tax, counties also received the option of levying a one-quarter cent sales and use tax.[43] However, a county could not levy the land transfer tax at the same time as the local option one-quarter cent sales and use tax.

To date, no county has achieved voter approval to levy this local land transfer tax, although 21 counties have conducted public referendums. The 21 counties are Ashe, Avery, Brunswick, Chatham, Clay, Davie, Gates[44] Graham, Harnett, Henderson, Hoke, Johnston, Macon, Moore, Orange, Pender, Polk, Rutherford, Swain, Tyrrell[45] and Union.

However, the General Assembly has given four counties the authority to levy a land transfer tax on instruments conveying an interest in real property without a referendum: Dare,[46] Currituck,[47] Chowan,[48] and Camden.[49] The General Assembly has authorized the following three counties to levy, upon approval of the voters, a land transfer tax: Pasquotank,[50] Perquimans,[51] and Washington.[52] This act does not affect these local authorizations.

Tax of Improved Prop. in Roadway Corridors.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-30	**SB 107**	**Sen. Brunstetter, Garrou**

AN ACT TO REDUCE THE PROPERTY TAX OWED FOR IMPROVED PROPERTY INSIDE CERTAIN ROADWAY CORRIDORS.

OVERVIEW: This act classifies improved property inside a roadway corridor as a special class of property and provides that it will be taxable at 50% of its appraised value.

FISCAL IMPACT: The act does not affect State General Fund revenues. It will reduce local property tax revenues in counties where such property exists. *(For a more complete fiscal*

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[42]The State excise tax on conveyances is imposed at the rate of $1 for each $500 of sales price. The proceeds from this tax are distributed as follows: ½ to the county for any public purpose, and the remaining ½ to the Department of Revenue (75% goes to Parks and Recreation Trust Fund and 25% goes to Natural Heritage Trust Fund). The following transfers are exempt from the State excise tax on conveyances: (1) by operation of law; (2) by lease for a term of years; (3) by will; (4) by intestacy; (5) by gift; (6) no consideration paid; (7) by merger, conversion, or consolidation; and (8) by instrument securing indebtedness. This act does not affect the imposition of the State excise tax.

[43] To date, 18 counties have successfully enacted the local option one-quarter cent sales and use tax authorized by the 2007 legislation.

[44] Gates County conducted two public referendums, one on November 6, 2007 and one on May 4, 2008.

[45]Tyrrell County conducted two public referendums, one on May 4, 2008 and one on November 4, 2008.

[46] S.L. 1985-525.

[47] S.L. 1985-670.

[48] S.L. 1985-881.

[49] S.L. 1985-954.

[50] S.L. 1989-393.

[51] S.L. 1989-393.

[52] S.L. 1989-393. The issue has been on ballot three times, but has never passed.

analysis, see Overview: Fiscal and Budgetary Actions, 2011 Session. Available in the Legislative Library.)

EFFECTIVE DATE: This act becomes effective for taxes imposed for taxable years beginning on or after July 1, 2011, and sunsets for taxes imposed for taxable years beginning on or after July 1, 2021.

ANALYSIS: Article V, Sec. 2(2) of the North Carolina Constitution grants the General Assembly the power to classify property for taxation. That power must be exercised on a State-wide basis, by uniform rule, in a general law uniformly applicable in every unit of local government. In 1987, the General Assembly classified *unimproved* property in a transportation corridor marked on an official map as a special class of property and provided that it would be taxable at 20% of its appraised value. This act classifies *improved* property within a transportation corridor marked on an official map as a special class of property and provides that it is taxable at 50% of its appraised value.

A transportation corridor map may be adopted by the governing body of a local government as part of a comprehensive plan for streets and highways or by the Department of Transportation for part of the State highway system. Once a transportation corridor official map is filed with the register of deeds, no building permit may be issued for any building or structure on the property for up to three years.[53] If a building or structure exists on the property at the time the map is recorded, a permit may be issued provided the size of the building or structure is not increased.

There is no limit on how long the filer of a transportation corridor map may keep a proposed route on a map without purchasing the property. Although a proposed route does not prevent the sale of the property, it does affect the salability of the property because lenders and purchasers may not want to purchase property that may eventually be part of a highway corridor. A property owner may petition the filer of the map for acquisition of the property due to an undue hardship on the affected property owner.[54]

The Department of Transportation's ability to purchase property in recent years has been hampered by fiscal constraints. This constraint has placed a hardship on some property owners located in a transportation corridor. The reduction in the property tax assessment is one way to ease the financial burden on the property owners. However, the reduction in the property's tax value reduces the property tax revenue available to the counties in which these corridors lie. The Department of Transportation identified the roadway corridors that are not scheduled for near-term right-of-way acquisition. The corridors included six projects located in five counties: Currituck, Forsyth, Johnston, Pitt, and Wake. The cumulative revenue loss for the improved property located in these five counties is just over one-half million dollars.

The 10-year sunset provided in the act recognizes that it addresses a State issue, namely the length of time between when property is marked on a transportation corridor map and when it is purchased by the State, with a property tax expenditure that reduces local tax revenues.[55]

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[53] G.S. 136-44.51.

[54] G.S. 136-44.53. In the last nine years, 684 hardship advance acquisition requests in protected corridors have been received with approximately 500 receiving approval. Most hardship requests are related to financial or medical difficulties.

[55] In Forsyth County, the Winston-Salem Beltway has over $80 million in previously purchased right-of-way; however, there is another $360 million in right-of-way that will need to be acquired to complete the project. The fiscal constraints delaying the acquisition of the property have meant that the owners of this property have few options for the use of the property. The owners of this property understand it

The sunset gives the General Assembly an opportunity to review the policy in the future. The Department of Transportation began addressing some of the issues associated with property located in a protected corridor with changes to its current process: proposed evaluation of each protected corridor every 10 years; establishment of key criteria to aid in determining whether a corridor official map should be filed; and greater flexibility within existing law as to allowable property/home improvements.

Municipal Service District/Streets.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-72	**SB 281**	**Senator Stein**

AN ACT TO AUTHORIZE CITIES TO ESTABLISH A MUNICIPAL SERVICE DISTRICT FOR THE PURPOSE OF CONVERTING PRIVATE RESIDENTIAL STREETS TO PUBLIC STREETS AND TO AUTHORIZE RELATED COMMUNITY ASSOCIATIONS TO TRANSFER PLANNED COMMUNITY PROPERTY TO CITIES.

OVERVIEW: This act expands the purposes for which a city may create a municipal service district to include the conversion of private streets to public streets. The scope of the act is written to effectively limit its applicability to the following municipalities: Durham, Morrisville, and Raleigh.

FISCAL IMPACT: A city may impose a higher property tax rate on the taxpayers within a municipal service district to pay for the additional services received in that district. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2011 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective when the Governor signed it into law on May 12, 2011.

ANALYSIS: Article V, Sec. 2(4) of the North Carolina Constitution allows the General Assembly to enact *general* laws authorizing the governing board of a local governmental unit to define territorial areas and to levy additional taxes within those areas to finance a service that is provided to a greater extent in that area than is provided to the entire area of the governmental unit. Article 23 of Chapter 160A provides the general law authorization that allows a city to establish a municipal service district and to levy a property tax in that district that is in addition to the property tax levied in the city as a whole. Article 23 specifies the purposes for which a municipal service district may be created.[56] This act expands the list of purposes to include the conversion of private streets to public streets, but the expansion only applies to the cities of Durham, Morrisville, and Raleigh.

This legislation addresses an issue specific to the Town of Morrisville. There are 14 residential developments in the Town of Morrisville that were constructed with private streets.[57] The private

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may be as much as 20 years before the beltway is built. The fiscal loss to Forsyth County of this act is $385,714.

[56] Beach erosion control; flood and hurricane protection works; a service which a city may by law provide, such as placing utility wiring underground; downtown revitalization projects; transit-oriented development projects; drainage projects, sewage collection and disposal systems; lighting at interstate highway interchange ramps; off-street parking facilities; and watershed improved projects.

[57] These 14 developments comprise about one-third of Morrisville's homes.

streets were constructed to a lesser standard than public streets. Of these 14 neighborhoods, five have submitted petitions to the Town Council signed by more than 60% of the residents requesting the town to upgrade and convert the streets to publicly maintained streets.[58] The Town does not have the authority to expend public funds for private streets.[59] To address the issue brought to the Town by its residents, the Town sought authority from the General Assembly to create a municipal service district for the purpose of converting the private streets to public streets. The conversion would include the transfer of ownership of the streets, an evaluation of the condition of the streets, and the design and construction costs related to improving the private streets to meet public streets standards.

Article XIV, Sec. 3 of the North Carolina Constitution prohibits local acts where general laws are directed; however, the Constitution does allow for classification by population. Not all municipalities wanted the ability to create special tax districts for the purpose of converting private streets to public streets. Therefore, the legislation is limited to a city that meets one of the following population classifications:

> Located primarily in a county with a population of 750,000 and also in a county with a population of 250,000. The only two cities that meet this classification are Morrisville and Raleigh.
>
> Located primarily in a county with a population of 250,000 and also in a county with a population of 750,000. The only city that meets this classification is Durham.

The act also creates the following limitations upon the creation of a district for this purpose:

> The private road must be non-gated.
>
> A city must receive a petition signed by 60% of the lot owners of the area to be included within the special district requesting the city to establish the district.
>
> A city must be willing to accept the converted streets for perpetual public maintenance.
>
> The additional tax rate levied in the special district may not exceed 30% of the property tax rate currently imposed in that district in the fiscal year prior to the establishment of the district.
>
> After the private streets have been upgraded to meet public street standards and all of the costs have been recovered, the district must be abolished.

To create a municipal service district, a city must hold a public hearing on a proposed resolution. The resolution must define the service district and find that the area defined is in need of one or more of the services for which a district may be created to a demonstrably greater extent than the remainder of the city. The resolution may become effective at the beginning of a fiscal year. Once a district is created, the city must provide or let contracts for the service for which the residents of the district are being taxed within one year of the effective date of the district. A city may incur debt, as allowed under general law and supported by the property tax levy, to finance services within a service district. When there is no longer a need for the service district, the district must be abolished.

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[58] Three neighborhoods are continuing to collect petitions; the remaining seven have indicated no interest in pursuing the issue.

[59] G.S. 153A-205 gives counties the authority to expend funds for the cost of improvements needed to bring residential streets up to State standards so they may become part of the State-maintained system. An argument may be made that cities have authority under Article 10A of Chapter 160A of the General Statutes to impose a special assessment for this purpose, but it is not clear.

Level Playing Field/Local Gov't Competition.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-84	**HB 129**	**Rep. Avila, Howard, Carney, Wainwright**

AN ACT TO PROTECT JOBS AND INVESTMENT BY REGULATING LOCAL GOVERNMENT COMPETITION WITH PRIVATE BUSINESS.

OVERVIEW: This act creates new requirements for cities and joint agencies that operate a communications service that is offered to the public for a fee.

FISCAL IMPACT: General Fund revenue for new cities that elect to operate communications service is estimated at $18.98 per subscriber. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2011 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective when the Governor signed it into law on May 21, 2011.

ANALYSIS: Under G.S. 160A-311, cities are authorized to operate and finance a number of public enterprises, including cable television systems. A North Carolina Court of Appeals case, *BellSouth Telecommunications, Inc. v. City of Laurinburg*, 168 N.C. App. 75, 606 S.E. 2d 721 (2005), interprets the statutory authority to operate a cable television system to include operation of a fiber optic network. Morganton (CoMPAS Cable TV), Salisbury (Fibrant), Wilson (Greenlight), and Mooresville and Davidson (MiConnection) currently offer cable and internet service as a public enterprise.

The cities that currently operate cable and internet systems financed their systems through the installment purchase contract method authorized by G.S. 160A-20. This financing mechanism is commonly known as certificates of participation. Under this financing method, a city enters into an installment contract secured by a security interest in the system that is constructed. Unlike the issuance of general obligation bonds, installment purchase financing is not subject to a vote of the people. The Local Government Commission must approve a local unit's use of certificates of participation and the unit must give notice and hold a public hearing before it can enter into certificates of participation involving real property.

This act created a new Article 16A in Chapter 160A of the General Statutes. The new Article provides the following:

Communications Service Definition: "Communications service" is defined as the provision of cable, video programming, telecommunications, broadband, or high-speed internet access service to the public for a fee. A "city-owned communications service provider" includes cities that offer the service through an interlocal agreement or joint agency. Data sharing between governmental entities for internal governmental purposes and service offered to the public for free are not included in the definition of "communications service" and therefore, not subject to the limitations in this act.

High-speed Internet Access Service Definition: "High-speed internet access service" is defined as service with transmission speeds equal to or greater than the basic broadband service as defined by the FCC for broadband tier 1 service for broadband data gathering and reporting.

Requirements for City-owned Communications Providers: City-owned communications service providers, unless otherwise exempt, must fulfill all of the following requirements:

Comply with all State, local, and federal laws and regulations a private company providing the same communications service is subject to.

Establish separate enterprise funds for the communications service and conduct annual audits of the communications service. The annual audit conducted under G.S. 159-34 satisfies this requirement.

Limit the provision of service to the jurisdictional boundaries of the city.

Provide nondiscriminatory access of the city's rights-of-way, poles, or conduits to other service providers.

Remit to its General Fund an amount equal to all the taxes and fees a private provider would pay if the private provider supplied the service.

City-owned communications service providers are prohibited from engaging in any of the following:

Using the city's authority to require individuals or developments to subscribe to the communications service.

Pricing the service below the cost of providing the service. The cost of providing the service must include the cost of capital components that would be equal to the cost of capital components a private provider would incur and an amount equal to all taxes a private provider would pay.

Providing advertisements of the city-owned communications service on PEG channels of competing providers if the PEG channel is required to be carried on the system of another service provider. The use of funds not allocated to the communications service for advertisement is also prohibited.

Subsidizing the provision of the communications service with other revenue.

Cities that choose to sell or discontinue a city-owned communications service are not required to hold a referendum prior to sale or discontinuation of the service.

Public Hearings: Prior to offering communications service, cities are required to hold at least two public hearings for comment on the service. The cities are required to provide notice for the hearings in the local newspaper and with the Utilities Commission. Private communications providers must be allowed to participate in the hearings. Feasibility studies, business plans, and public surveys for the communications service are deemed public records and must be available to the public prior to the hearings. The public hearing requirement does not apply to the repair or upgrade of an existing service.

Financing: Cities and joint agencies are prohibited from incurring debt, including installment purchase contracts and certificates of participation, for a communications system unless a special election is held. The question to be posed in the special election is whether or not the city may offer the communications service. The referendum requirement does not apply to repairs or improvements of an existing system.

Taxes, Payments in Lieu of Taxes: Cities and joint agencies operating a communications service will not receive a sales tax refund for purchases related to the provision of the communications service and are required to make the following payments in lieu of taxes:

To the applicable county, a payment of the amount of property taxes that would be due if the communications system was subject to the property tax.

To the State, an amount set by the Department of Revenue that approximates the amount of income, franchise, vehicle, motor fuel, and other taxes that would be due for a communications system subject to these taxes. Cities subject to this provision must provide information to the Department of Revenue necessary for the calculation of the payment. The amount of the assessment is set by January 1 of each year, and due by March 15 of each year.

Public-Private Partnerships for Communications Service: Cities are required to solicit proposals from private providers before constructing a communications network. Cities must issue request for proposals and provide notice to the public of the request for proposals. The city may consider any relevant factors, including system design, system reliability, operational experience, operational costs, compatibility with existing systems and equipment, and emerging technology. If the city in unable to negotiate terms with the two most responsive proposers, the city may proceed with offering communications service.

Designation as Public Utility: Cities and joint agencies that provide telephone service are included in the term "public utility" as defined by Chapter 62 of the General Statutes. Telephone service provided by these entities would be subject to oversight by the Utilities Commission.

Additional Financing Requirements: The Local Government Commission (LGC) must conduct additional review of applications to finance the construction, operation, expansion, or repair of a communications system by a city or joint agency. As part of the review, the following apply:

The public hearings required by Article 16A of Chapter 160A must be held before an application for financing may be submitted.

A copy of the application for financing must be given to private communications providers that serve the city and areas adjacent to the city. The LGC must accept written and oral comments from private providers as a part of the application review.

The LGC must consider and make written findings regarding the reasonableness of the revenue projections of the service in light of the current and projected competitive environment, the impact of innovation, and the level of community support for the project.

Revenue Bonds: The act authorizes cities to issue revenue bonds to finance a cable television system. Although a referendum is not normally required for revenue bonds, cities that offer communications service as defined in G.S. 160A-340.1 are subject to the requirements of G.S. 160A-340.4(b) to hold a referendum before incurring debt to construct a communications system.

Exemptions: There are two exemptions from the provisions of the act. Cities that provide service to "unserved areas" are exempt from certain provisions of the act. Cities providing service as of January 1, 2011, are exempt from the entirety of the act, provided those cities limit service to certain areas.

Unserved Areas: The provision of communications service in an area that has been established by order of the Utilities Commission to be an "unserved area" is exempt from certain provisions of the act. For the purposes of this determination, whether an area is unserved area is determined by census block, and is an area in which 50% of the households have no access to high-speed internet, or only access to high-speed internet from a satellite provider. The provision of communications service in an unserved area is exempt from the following provisions in Article 16A in Chapter 160A:

Requirements for city-owned communications providers.

The requirement to hold a special election prior to financing.

The requirement of payments in lieu of taxes.

Existing providers: Cities that offered communications service as of January 1, 2011, are exempt from all of the provisions in the act provided the city limits the provision of service to the following:

Persons within the corporate limits of the city providing the service. For the purposes of this section, the corporate limits include areas in the corporate limits as of April 1, 2011, and any later annexed areas.

Existing customers of the service as of April 1, 2011, provided contracts for service outside the service area provided in the act are subject to public bidding upon expiration.

Persons within the service areas provided in the act. A city that is subject to a service area boundary will have 30 days from discovery or notice of providing service outside of the boundary to cease providing service outside the boundary without losing the exemption.

Prepaid Wireless/Point of Sale Collection.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-122	**HB 571**	**Rep. Sager, Justice, Bryant, Brawley**

AN ACT IMPOSING A SERVICE CHARGE ON EACH RETAIL TRANSACTION OF PREPAID WIRELESS TELECOMMUNICATIONS SERVICE FOR ANY PURPOSE OTHER THAN RESALE OCCURRING IN THIS STATE, REQUIRING THAT THE SERVICE CHARGE BE COLLECTED BY THE SELLER OF PREPAID WIRELESS TELECOMMUNICATIONS SERVICE AND REMITTED TO THE DEPARTMENT OF REVENUE, AND PROVIDING THAT THE DEPARTMENT OF REVENUE SHALL TRANSFER ALL SERVICE CHARGES COLLECTED, MINUS THE COSTS OF COLLECTION, TO THE 911 FUND TO SUPPORT 911 SERVICES IN THE STATE.

OVERVIEW: This act provides for the collection of the 911 service charge on prepaid wireless service at the point of retail sale.

FISCAL IMPACT: There is no fiscal impact on General Fund revenues. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2011 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The repeal of the current methods of collection the 911 service charge from prepaid wireless service was effective when signed by the Governor on June 9, 2011. The remainder of this act is effective July 1, 2013 and applies to retail transactions on or after that date.

ANALYSIS: Prior to 2007, North Carolina local government entities collected a 911 service charge from subscribers of local telephone providers, and the Wireless 911 Board collected a monthly service charge from subscribers of wireless providers. In 2007, the local 911 service charge was eliminated, and a new statewide administrative system was adopted for collection and distribution of the 911 service charge.

The intent of this legislation was to collect a uniform fee from all providers, including the collection of the charge from prepaid wireless customers. Providers of prepaid wireless service were authorized to collect the 911 service charge using either of the following methods:

Decrement – The monthly charge is collected by decrementing the service charge from each active prepaid wireless customer with an account balance equal to or greater than the amount of the service charge.

Average Rate Per User - The monthly payment for 911 service charges for each provider of prepaid wireless service is determined based on its sales of prepaid revenue in the State during the month.[60]

Due to concerns regarding the methods of collection, the original legislation provided a moratorium on the collection of the 911 charge from prepaid customers for one year after. The moratorium has been extended three times and is in effect through calendar year 2011.[61]

This act repeals the current method of collection and provides for the retail collection of the 911 service charge for prepaid wireless service. The 911 service charge for prepaid wireless must be the same as the monthly charge for 911 service imposed on all other phone subscribers. The service charge will be collected by retailers and administered by the Department of Revenue. The 911 service charge for prepaid wireless service will be the same charged for postpaid service, 70¢ on each retail transaction of prepaid wireless service, or a lower amount set by the Board.

Each seller of prepaid wireless will collect the 911 service charge and remit the charge to the Department of Revenue. A seller must remit the charges either monthly, or semiannually. For administrative costs, each retailer is allowed to retain all of the 911 service charges for prepaid wireless that it collects in the first three months after the effective date of the act, and 5% of the charges thereafter.

The Department of Revenue will collect the 911 service charge for prepaid wireless from the retailers and remit the charges collect to the 911 Board each month within 45 days of the end of the month. The Department may retain the cost of collection not to exceed $700,000 for the first year after the effective date of this act and not to exceed $500,000 each year thereafter.

The funds remitted to the 911 Board from prepaid service will be distributed for the administration of 911 service as provided in the statutes for postpaid service. Currently a portion of the 911 service charges is allocated to reimburse wireless providers to pay for upgrades to their system necessary for the implementation for enhanced 911. The upgrades allow the wireless phone systems to provide address and location information to the 911 call centers. The remainder of the 911 service charges is distributed to public safety answering points (PSAPs) for 911 service. This section clarifies that the 911 service charge from prepaid wireless service will be not allocated for reimbursements for wireless providers. All 911 service charges collected at retail from prepaid wireless transactions will be distributed to PSAPs.

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[60] The provider's prepaid revenue in the state is divided by the "average revenue per user" and then multiplied by the amount of the service charge. The average rate per user in the statute is currently $50.

[61] Section 1 of S.L. 2008-134, Section 1 of S.L. 2009-90, and Section 43 of S.L. 2010-95.

Modify Property Tax Base Exclusions.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-123	**HB 206**	**Rep. Ross, Jackson, Gill**

AN ACT TO MODIFY THE PROPERTY TAX BASE EXCLUSIONS.

OVERVIEW: This act excludes from property tax a contiguous tract of commercial property that is significantly damaged by fire or explosion and donated to a nonprofit corporation.

FISCAL IMPACT: Due to the narrow circumstances under which a property may qualify for this exclusion, the revenue impact is expected to be minimal. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2011 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The act is effective for taxes imposed for taxable years beginning on or after July 1, 2011, and expires for taxable years beginning on or after July 1, 2016.

ANALYSIS: All real and personal property is subject to property tax unless it is excluded or exempted from the tax base. Article V, Sec. 2(2) of the North Carolina Constitution provides that the power to classify property for taxation lies with the General Assembly and must be exercised on a State-wide basis and made by general law uniformly applicable in every county and city.

This act designates property meeting the following requirements as a special class of property under Article V, section 2(2) of the North Carolina Constitution and excludes it from property taxation:

> The property must be a contiguous tract of land previously used primarily for commercial or industrial purposes and damaged significantly as a result of a fire or explosion.
>
> The property must have been donated to a nonprofit corporation by an entity other than an affiliate.
>
> The property must not have been leased or sold by the nonprofit corporation.

This legislation addresses an issue specific to the Town of Garner. The ConAgra plant in Garner was damaged significantly as a result of a fire or explosion in June 2009. ConAgra wanted to donate the property to the Town of Garner so the Town could redevelop and market the property. The Town believed this task could be handled more efficiently by a private corporation. The Garner Economic Development Corporation was formed on November 22, 2010, as a nonprofit corporation. One of its stated purposes is to acquire funds and real property related to the ConAgra plant and to maintain, develop, and market the property for economic development.

Although the property would be exempt from taxation if held by the Town, the property is subject to tax since it is owned by a nonprofit corporation. G.S. 105-278.7 provides a property tax exemption for property used for educational, scientific, literary, or charitable purposes. In 2002, the Attorney General's office issued an opinion that property owned by the Charlotte/Mecklenburg Development Corporation was not entitled to a charitable exemption where the corporation's goal was to undertake site development and sell the property to businesses. Although the property was owned by a nonprofit entity, it was not held for a charitable purpose.

Since the nonprofit corporation created for the purpose of redeveloping and marketing the property in the Town of Garner does not have an initial cash flow, the Town sought legislation exempting the property from taxation. The language in the act is crafted to apply only to the property donated to the nonprofit corporation by the ConAgra plant, and the exclusion only applies for five years.

Appropriations Act of 2011.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-145, as amended by S.L. 2011-330	**HB 200**	**Representative Brubaker**

AN ACT TO SPUR THE CREATION OF PRIVATE SECTOR JOBS; REORGANIZE AND REFORM STATE GOVERNMENT; MAKE BASE BUDGET APPROPRIATIONS FOR CURRENT OPERATIONS OF STATE DEPARTMENTS AND INSTITUTIONS; AND TO ENACT BUDGET RELATED AMENDMENTS.

OVERVIEW: This act, known as the Current Operations and Capital Improvements Appropriations of 2011, contains a $19.7 billion budget for fiscal year 2011-12 and a $19.9 billion budget for fiscal year 2012-13.[62] The act also contains a finance package that allows a $50,000 personal income tax deduction for net business income, changes the starting point for calculating North Carolina taxable income from federal taxable income to federal adjusted gross income, and exempts from the franchise tax base reserves for amortization of intangible assets.

FISCAL IMPACT: The act reduces budget availability by $131.6 million in fiscal year 2011-12 and by $335.6 million in fiscal year 2012-13 for a total finance package of $467.2 million for the biennium. This tax relief is in addition to the $1.3 billion in expiring tax revenue.[63] The act generates State and county revenues of $100.9 million in fiscal year 2011-12 and $101.4 million in fiscal year 2012-13 by increasing various fees. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2011 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The two income tax provisions become effective for taxable years beginning on or after January 1, 2012. The franchise tax provision became effective retroactively for tax years beginning on or after January 1, 2007.

ANALYSIS: Part XXXI-A of the act contains three finance provisions.

Personal Income Tax Exemption for Business Income.[64] – Section 31A.1 adds a new deduction for "net business income" when calculating North Carolina taxable income for personal taxes.

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[62] This document does not summarize the budget expenditure provisions; it only summarizes the finance law provisions.

[63] The 1% State sales tax rate expires July 1, 2011; the corporate and individual income surtaxes expire for taxable years beginning on or after January 1, 2011.

[64] This provision originated in the Senate Finance Committee Substitute, HB 200, Version 5. The provision in Versions 5 and 6 of HB 200 limited the deduction to a business whose cumulative gross receipts from all business activity in a taxable year did not exceed $825,000; and it sunset the deduction for taxable years beginning on or after January 1, 2014. The provision as enacted is not limited to businesses of a certain size and it does not sunset.

The deduction allows an individual taxpayer to exclude the first $50,000 of net business income received during the taxable year. To qualify, the income must be subject to personal tax and be business income from an activity where the taxpayer actively participates. Business income is defined to exclude income deemed passive under the federal tax rules.

There is no limit on the size of the business. The business must be subject to personal taxes. Businesses subject to personal taxes on individual taxpayer's returns include sole proprietorships, partnerships, S corporations, and limited liability companies.[65] Very large businesses tend to be taxed at the corporate level under Subchapter C of the Internal Revenue Code - referred to as "C corporations." These C corporations do not qualify for the deduction.

Typically, non-passive business income would appear on an individual taxpayer's federal income tax return on schedules C, E, and F. Schedule C reports income from sole proprietorships. Schedule E reports income from partnerships and S corporations. Schedule F reports income from farming. Any income deemed passive under federal tax rules would not qualify. For example, rental income is generally considered passive.

Using Federal AGI as the Starting Point for State Taxable Income.[66] – Section 31A.1 changes the starting point for calculating NC taxable income from federal taxable income to federal adjusted gross income. This change did not change the tax base or increase North Carolina tax in any way. All current deductions and credits remain.[67]

The switch to federal adjusted gross income (AGI) as the starting point simplifies the calculation of North Carolina taxable income because North Carolina taxpayers no longer have to make adjustments to reduce the federal standard deduction and federal exemption amounts to determine the applicable State deduction and exemption amounts.[68] Now, taxpayers may start with federal AGI and deduct the State personal exemption amounts and, if the taxpayer does not itemize deductions,[69] the State standard deduction amounts, to calculate State taxable income.

Of the 35 states that begin their calculation of state taxable income with federal law, 29 use federal adjusted gross income while only six use federal taxable income. Federal taxable income is income after all federally allowed deductions; it includes the deductions from gross income to determine adjusted gross income and the deductions from adjusted gross income to determine taxable income. The primary differences between federal taxable income and adjusted gross income are the personal and dependency exemptions and the subtraction of either the standard deduction amount or the itemized deductions amount.

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[65] Assuming the LLC has not elected to be taxed at the corporate level.

[66] This provision originated in the Senate Finance Committee Substitute, HB 200, Version 5. The provision in Versions 5 and 6 of HB 200 would have also reduced each of the personal income tax rates by ¼%. To help offset the revenue loss from the rate reductions, the bills would have eliminated the personal income tax deductions for severance wages and qualified sales of a manufactured home community and the tax credit for oyster shell recycling; they also would have eliminated the sales tax exemption for nutritional supplements sold by a chiropractor at a chiropractic office and the sales tax holiday for certain energy star products.

[67] Section 12 of S.L. 2011-330 amended this section of the budget to ensure that the changes made by it did not inadvertently change the existing tax base in ways that were not intended

[68] In 1989, when North Carolina first began using federal taxable income as its starting point, the federal and State personal exemption and standard deduction amounts were the same. Since 1989, the federal amounts have been indexed and the State amounts have not.

[69] More than 70% of North Carolina taxpayers claim the standard deduction amount rather than itemize their deductions.

North Carolina began using federal taxable income as the starting point for this calculation in 1989. At the time, this change significantly simplified North Carolina's individual income tax by eliminating 30 individual income tax exclusions and reducing 47 deductions and exemptions to seven.[70] Since that time, however, the number of adjustments a taxpayer must make to federal taxable income to determine North Carolina taxable income has increased from 11 to more than 40. North Carolina's current system of additions and subtractions is confusing to taxpayers and complex to administer.

Franchise Tax Base Modification.[71] – Section 31A.2 provides an exemption of reserves for amortization of intangible assets from surplus and undivided profits, thus excluding them from the franchise tax capital base. Examples of intangible assets include goodwill, patents, copyrights, franchises, trademarks and trade names, as well as going concern value.

Some taxpayers deducted reserves for amortization of intangible assets prior to the law change because it is an allowable deduction under Generally Accepted Accounting Principles (GAAP). The Department disallowed the deduction and collected additional tax on taxpayers that elected to participate in the Department's Resolution Initiative. The law change was made retroactive to allow these taxpayers the benefit of the deduction.

Facilitate Electronic Listing.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-238	**HB 896**	**Representative Brubaker**

AN ACT TO FACILITATE ELECTRONIC LISTING OF PERSONAL PROPERTY FOR PROPERTY TAX PURPOSES.

OVERVIEW: This act authorizes the Department of Revenue, in consultation with the counties, to establish standards and requirements for the electronic listing of personal property allowed by counties.

FISCAL IMPACT: This act has no General Fund impact.

EFFECTIVE DATE: This act became effective when the Governor signed it into law on June 23, 2011.

ANALYSIS: All property, real and personal, within the jurisdiction of this State is subject to property tax unless it is excluded by statute or exempted by the Constitution. The property must be listed annually. Under prior law, a board of county commissioners could, by resolution, provide for electronic listing of personal property. If a county allows the electronic listing of personal property, the assessor must publish this information, including the timetable and procedures for electronic listing.

This act repeals the existing statutory authority that allows counties to provide for electronic listing of personal property and creates a new statute in its place that allows counties to provide for electronic listing of personal property only after the Department of Revenue has established standards and minimum requirements, in consultation with the counties. Once the standards have

[70] Chapter 728 of the 1989 Session Laws.

[71] This provision first appeared in the Senate Appropriations/Base Budget Committee Substitute, HB 200, Version 7.

been established, a county may, by resolution, provide for electronic listing. A county may also delegate this authority to the county tax assessor.

The act also makes other procedural changes related to electronic listing. Section 3 of the act provides that a resolution that includes a general extension of time for the electronic listing of personal property continues to be in effect until the resolution is revised or rescinded. It further provides that if a board grants an individual taxpayer an extension for good cause shown for the electronic listing of personal property, the extension may not extend beyond June 1. Under prior law, the period for electronic listing may only be extended to June 1, both generally and in individual cases. Other individual extensions could not extend beyond April 15. The act also eliminates the requirement that a person with a duty to list property appear before the assessor and substitutes a requirement to file a completed abstract along with the required affirmation.

Government Reduction Act.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-266	**SB 593**	**Sen. Clary, Brock, Soucek**

AN ACT REDUCING STATE GOVERNMENT BY ABOLISHING CERTAIN STATE BOARDS, COMMISSIONS, AND COMMITTEES.

OVERVIEW: Section 1.15 of S.L. 2011-266 repeals G.S. 120-70.108 that required the Revenue Laws Study Committee to establish a Property Tax Subcommittee.

FISCAL IMPACT: This section has no fiscal impact.

EFFECTIVE DATE: This section became effective July 1, 2011.

ANALYSIS: Section 1.15 of S.L. 2011-266 abolishes the Property Tax Subcommittee of the Revenue Laws Study Committee. The Property Tax Subcommittee formerly studied and, if necessary, recommended changes to the property tax system. The current jurisdiction of the Revenue Laws Study Committee under G.S. 120 70.106 includes the study of all the revenue laws of North Carolina.

Property Tax Uniformity for Conservation Land.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-274	**HB 350**	**Rep. McGrady, Starnes, Brubaker, Harrison**

AN ACT TO MODIFY WHEN LAND USED FOR CONSERVATION PURPOSES IS TO BE EXCLUDED FROM THE PROPERTY TAX BASE.

OVERVIEW: This act does the following:

- Clarifies and modifies the tax exemption for real property for educational and scientific purposes as a protected natural area[72] by listing certain, enumerated conservation purposes.
- Creates a 5-year rollback for avoided taxes if conservation property is no longer used for conservation purposes, is used to generate income inconsistent with conservation, or is sold or transferred without an easement requiring perpetual use of the listed conservation purposes and without a prohibition on income generation.
- Expressly aligns definitions for educational and scientific purposes with the property tax exemption for property used for educational and scientific purposes.
- Requires that, as does the income tax credit for real property donations for conservation purposes, the entity owning the property must be "organized to receive and administer lands for conservation purposes".
- Adds the requirement that property qualifying under this exemption either not earn income or only earn income that is merely incidental to and not inconsistent with conservation purposes.

FISCAL IMPACT: Because the bill includes provisions which will potentially reduce local revenues (the expansion of qualifying purposes) and increase local revenues (a 5-year roll-back for disqualifying events), it is not clear whether the bill will result in an overall reduction or increase in local revenues. The overall change in revenue is expected to be minimal.

EFFECTIVE DATE: This act is effective for taxes imposed for taxable years beginning on or after July 1, 2011.

ANALYSIS: G.S. 105-275 lists classes of property that are authorized by the North Carolina Constitution to be excluded from the property tax base. Under prior G.S. 105-275(12), one of those classes was real property (i) owned by a nonprofit corporation or association and (ii) exclusively held and used by its owner for educational and scientific purposes as a protected natural area. Educational purpose and scientific purpose were not defined as they were elsewhere for property tax benefits in G.S. 105-275(12); property qualifying under G.S. 105-275(12) was excluded from the property tax base and, therefore, escaped property tax liability altogether; and whether the property earned income was not relevant to a determination of the property tax benefit afforded by G.S. 105-275(12).

This act modifies G.S. 105-275 (12) in various ways.

- It clarifies that the definitions for educational purpose and scientific purpose have the same meanings as defined in G.S. 105-278.7 (real and personal property used for, *inter alia*, educational or scientific purposes.)
- It expands the previous qualifying use (that land be used as a protected natural area) with the following, additional conservation purposes:
    - Managed under a written wildlife habitat conservation agreement with the North Carolina Wildlife Resources Commission

[72] A protected natural area is a nature reserve or park in which all types of wild nature, flora and fauna, and biotic communities are preserved for observation and study

- Managed under a forest stewardship plan developed by the Forest Stewardship Program.[73]
- Used for public access to public waters or trails.
- Used for protection of water quality and subject to a conservation agreement.[74]
- Held by a nonprofit land conservation organization for sale or transfer to a local, state, or federal government unit for conservation purposes.

- Property taxes avoided for up to the preceding 5 fiscal years are no longer eliminated but, instead, are carried forward as deferred taxes that become due and payable if a disqualifying event occurs. The following operate as disqualifying events:
  - The land is no longer used for one of the qualifying conservation purposes or is used to produce income inconsistent with the conservation use/s to which the land is applied.
  - The conservation organization transfers the land without an easement that requires the conservation use/s required for the land to qualify for the property tax benefit will continue to be applied and that prohibits income generation.
- It adds a requirement that property excluded from the tax base for conservation purposes not earn income or only earn income that is both incidental to and not inconsistent with the conservation purpose (e.g., a forest tract could not be managed for the commercial production of timber but some trees could be harvested if the harvesting is incidental and needed to accomplish the overall conservation purposes for which the tract is being managed)

Sales & Use Tax Overcollection.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-293	**HB 93**	**Rep. Howard, Setzer, Brubaker, Starnes**

AN ACT TO ALLOW A SELLER TO APPLY OVERCOLLECTED SALES TAX TO OFFSET A USE TAX LIABILITY ON A RELATED TRANSACTION.

OVERVIEW: This act allows a seller to apply overcollected sales tax to offset a use tax liability on a related transaction.

FISCAL IMPACT: There is no fiscal impact because the act has no effect on the amount of sales and use tax due.

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[73] Authorized by the Cooperative Forestry Assistance Act of 1978, this Program provides technical assistance, through State forestry agency partners, to nonindustrial private forest owners to encourage and enable active long-term forest management.

[74] Conservation agreements are governed by the provisions of the Conservation and Historical Preservation Agreements Act, Article 4, Chapter 121 of the General Statutes

EFFECTIVE DATE: This act became effective July 1, 2011, and applies to tax liabilities that accrue on or after that date.

ANALYSIS: Generally speaking, the sales tax that a retailer collects is considered a debt from the purchaser to the retailer until it is remitted by the retailer to the State. The retailer is considered to act as a trustee on behalf of the State when it collects tax from the purchaser of a taxable item. When a seller collects tax in excess of the amount that should have been collected or when a seller collects tax on an exempt or nontaxable sale, the total amount collected must be paid over to the Secretary of Revenue. A retailer is not entitled to a refund of any amount of overcollected sales tax unless the purchaser receives credit for or is refunded the amount of tax overcollected. A cause of action against a seller for overcollected sales or use tax does not accrue until a purchaser has provided written notice to a seller and the seller has had 60 days to respond.

This act arose from a situation where a retailer collected and remitted sales tax on transactions that the Department of Revenue later determined were not subject to sales tax because the property was *used* by the retailer. In that instance, the retailer owed use tax on the property. Specifically, this company is in the business of selling and servicing office equipment, primarily copiers. The company collected sales tax on the sale of its service agreements rather than collecting use tax on the parts and supplies used to fulfill the service agreements. The company sought a credit in the amount of sales taxes it paid against the use tax it owed. Because the retailer could not or chose not to refund the erroneously collected tax to the people who paid it, a refund of the erroneously collected sales tax was not allowed under the existing statute. In this situation, the State effectively collected both sales tax and use tax on the same transactions. The matter was heard by the Business Court, which issued an order in favor of the taxpayer on January 4, 2010. The State has appealed.

This act modifies the statute in such a way that a retailer in the circumstances described above could offset its use tax liability with overcollected sales tax. Specifically, the Secretary of Revenue may take one of the following three actions when he or she determines that a seller has overcollected sales tax on a transaction:

Allow a refund of the tax if the seller gives the purchaser credit for or a refund of the overcollected tax. However, no refund would be given if the seller has elected to offset a use tax liability on a related transaction with the overcollected sales tax.

If the seller is liable for use tax on a related transaction, allow the seller to offset the use tax liability with the overcollected sales tax. However, no offset would be permitted if the seller elected to receive a refund of the overcollected sales tax. The fact that a seller is allowed an offset does not affect the liability of the seller to the purchaser for the overcollected tax.

If neither (1) or (2) apply, retain the total amount collected on the transaction.

Small Business Assist. Records/Tax Payments.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-297	**SB 385**	**Senator Hartsell**

AN ACT TO PROVIDE THAT SMALL BUSINESS ASSISTANCE RECORDS AND FINANCIAL STATEMENTS ARE NOT PUBLIC RECORDS AND TO ALLOW A PASS-THROUGH ENTITY

THAT CLAIMS A TAX CREDIT UNDER ARTICLE 3J TO TREAT THE CREDIT CLAIMED AS A TAX PAYMENT MADE BY OR ON BEHALF OF THE TAXPAYER.

OVERVIEW: This act does two things:

- It exempts from the public records law certain documents between an individual and a State entity related to business counseling or technical assistance provided by the entity to the individual.[75]
- It allows the owner of a pass-through entity that claims a tax credit under Article 3J of Chapter 105 of the General Statutes to treat some or all of the credit as a tax payment made by or on behalf of the taxpayer. By treating the credit as a tax payment, the taxpayer would be able to deduct from another state's tax calculation the taxpayer's tax paid to North Carolina, including any amount for which it received a credit.

FISCAL IMPACT: This act has no fiscal impact.

EFFECTIVE DATE: The provisions of the act related to the tax treatment of an Article 3J tax credit is effective for taxable years beginning on or after January 1, 2011.

ANALYSIS: Income may be taxable in more than one state. In those instances, a taxpayer may claim a credit for income tax paid to another state on the tax return the taxpayer files with his home state. The credit for tax paid to another state gives the taxpayer relief from being taxed twice on the same income. The credit is only allowed for tax paid. When a taxpayer receives a tax credit in the other state against the tax owed on that income, such as a credit for job creation or business investment, the credit reduces the amount of tax paid to that state, and effectively reduces the credit that may be claimed on the return due to the home state for tax paid to another state.

This act allows a pass-through entity to treat a tax credit received under Article 3J of Chapter 105 of the General Statutes[76] as a tax payment made by or on behalf of the taxpayer. By electing to treat the credit as a tax payment, nonresident members of a pass-through entity will not have their credit for taxes paid to another state reduced on their home state's return.

Various Economic Development Incentives.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-302	**HB 751**	**Representative McComas**

AN ACT TO EXPAND THE APPLICATION OF THE ONE PERCENT, EIGHTY DOLLAR EXCISE TAX ON CERTAIN MACHINERY AND EQUIPMENT TO SPECIALIZED EQUIPMENT USED AT A PORT FACILITY AND TO MACHINERY USED AT A LARGE MANUFACTURING AND DISTRIBUTION FACILITY; TO PROVIDE TIER ONE TREATMENT FOR PORT ENHANCEMENT ZONES; TO RETAIN AND ENCOURAGE INVESTMENT IN ECONOMICALLY DISTRESSED TIMES TO REMAIN ELIGIBLE TO TAKE AN INSTALLMENT OF A CREDIT EARNED UNDER THE BILL LEE ACT; AND TO AMEND THE AUTHORIZATION TO ISSUE SPECIAL INDEBTEDNESS FOR AN EDUCATIONAL BUILDING AT APPALACHIAN STATE UNIVERSITY.

[75] This document does not summarize this change.

[76] Article 3J provides tax credits for creating jobs and investing in machinery and equipment.

OVERVIEW: This act does the following[77]:

- It expands the 1%, $80 excise tax applicable to equipment used to manufacture products by adding equipment used to distribute and assemble products.
- It expands favorable tax provisions applicable to a tier one county to areas designated as "port enhancement zones."
- It allows a taxpayer to continue to claim the tax credit for substantial investment in other property even though the requisite number of people employed at the location falls below the statutory requirement so long as the taxpayer has made a substantial investment in the property within two years of the date the employment fell below the requisite number.

FISCAL IMPACT: The provisions in the act that allows a taxpayer to remain eligible for the remaining installments of its Article 3A tax credit will reduce revenue by approximately $400,000 annually for five years, beginning in fiscal year 2010-11. The remaining provisions in the act do not impact revenues in this biennium, but will reduce General Fund revenues by more than $100,000 beginning in fiscal year 2013-14. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2011 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The expansion of the 1%, $80 excise tax to include distribution and assembly equipment becomes effective July 1, 2013. The expansion of the tier one benefits to port enhancement zones becomes effective for taxable years beginning on or after January 1, 2013. The retention of the remaining installments of an Article 3A tax credit becomes effective retroactively for taxable years beginning on or after January 1, 2009.

ANALYSIS: This act amends three different tax incentives: the 1%, $80 excise tax for mill machinery, Article 3J tax credits, and the Article 3A tax credit for substantial investment in other property.

Part I: Expand Excise Tax on Mill Machinery

North Carolina has long provided a preferential sales tax rate for mill machinery of 1% with an $80 cap per article.[78] The 2001 General Assembly enacted the excise tax in Article 5F in response to the requirement of the Streamlined Sales and Use Tax Agreement that states must simplify their sales tax rates.[79] Items subject to the excise tax in Article 5F are exempt from sales and use tax. The current State sales tax rate is 4.75%; the local rates vary from 2% to 2.5% in Mecklenburg County.

The preferential rate applies to a manufacturing industry or plant that purchases mill machinery. The statute does not define "manufacturing," but North Carolina court cases define the term as the making of a new product by the application of skill and labor to the raw materials of which

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[77] The act allows bond proceeds allocated to Appalachian State University for an educational building to be used for improving property as well as acquiring property. This provision is not summarized in this document.

[78] North Carolina enacted a 3% sales tax rate in 1933. In 1935, the General Assembly enacted a preferential 1% rate for mill machinery. In 1937, the General Assembly enacted a cap per article of $10.

[79] The 2001 legislation, which became effective January 1, 2006, repealed the 1% sales tax rate, with an $80 cap, imposed on mill machinery purchased by a manufacturing industry or plant and replaced it with a privilege tax having the same rate.

it is composed.[80] Section 57 of the Sales and Use Tax Bulletins and final decision issued by the Department of Revenue in 2003 reiterated that the preferential rate applied only to equipment used in the manufacturing process, not to equipment used in distribution or movement of manufactured products or to equipment used in the administrative work of the taxpayer.

Since 2005, Article 5F has been expanded to apply to purchases of fuel by a manufacturing plant, as well as machinery. It has also been expanded to include the following:

Certain personal property purchased by a major recycling facility.

Equipment purchased by a research and development company in the physical, engineering, and life sciences and used by that company in the research and development of tangible personal property.

Equipment purchased by a software publishing company that is used in the research and development of tangible personal property.

Equipment purchased by an eligible datacenter.

Specialized equipment used at a port facility.[81] – The act expands the 1%, $80 preferential tax rate to include specialized equipment used at a ports facility to unload or process bulk cargo to make it suitable for delivery to and for use by manufacturing facilities. This change in the law becomes effective July 1, 2013, and applies to purchases made on or after that date. The effective date ensured the provision would not impact the current fiscal biennium. There are no known projects at this point that would benefit from the preferential tax rate, but there have been taxpayers in the past interested in this type of incentive. The fiscal impact of this change is unknown.

Large manufacturing and distribution facility.[82] – The act creates a definition of a "large manufacturing and distribution facility" and expands the preferential 1%, $80 excise tax to include machinery used at the facility for assembling products and distributing finished products. Machinery located at such a facility for manufacturing products is already subject to the excise tax. The Winston Salem Journal reported on June 21, 2011, that Ashley Furniture Industries, Inc. the largest U.S. furniture manufacturer and retailer, was considering Davie County as a possible location for a $200 million complex to serve the East Coast. The facility would receive unassembled product pieces that it would assemble and distribute. This possibility appears to have spurred the enactment of the preferential rate; however, unlike past incentive legislation, the minimum investment and employment levels of this incentive could be obtained by other distribution facilities.

A large manufacturing and distribution facility is defined as one for which an investment of private funds of at least $80,000,000 is made within five years after the date on which the first property investment is made and one that will achieve an employment level of at least 550 within five years after the date the facility is placed into service. If the required level of investment or employment is not timely made, achieved, or maintained, then the preferential rate is forfeited and the taxpayer becomes liable for past sales and use taxes that would otherwise have been due. If the rate is forfeited for failure to timely make the required investment or timely achieve the required employment level, then the preferential rate is

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[80] *Duke Power Co. v. Clayton,* 274 N.C. 505, 164 S.E.2d 289 (1968); *Sayles Biltmore Bleacheries, Inc. v. Johnson,* 266 N.C. 692, 147 S.E. 2nd 177 (1966); *Master Hatcheries, Inc. v. Coble,* 286 N.C. 518, 212 S.E.2d 150, (1975).

[81] The original bill made a variation of this amendment to Article 5F of Chapter 105.

[82] The House Finance Committee Substitute added this amendment to Article 5F to the bill.

forfeited on all purchases made. If the rate is forfeited for failure to maintain the required employment level, then the rate is forfeited only on those purchases occurring on or after the date the taxpayer failed to maintain the required employment level.

The preferential rate for distribution equipment purchased by a large manufacturing and distribution facility becomes effective for purchases made on or after July 1, 2013, and expires for sales occurring on or after July 1, 2018. The delayed effective date ensured the provision would not impact the current fiscal biennium. The fiscal impact of this change in future years is unknown.

In addition to the preferential tax rate, the act also provides a sales tax refund to a large manufacturing and distribution facility that purchases distribution equipment on or after July 1, 2012, and before July 1, 2013. The facility would receive a full refund of local taxes and a portion of State taxes. The portion of State taxes refunded is equal to the amount of tax paid less the amount of tax the facility would have paid had it been subject to tax under Article 5F. The taxpayer must make a written request for a refund on or after July 1, 2013, and before January 1, 2014. Although the refund provision applies to purchases made during this fiscal biennium, it is not payable until fiscal year 2013-14, thus ensuring that the provision would not impact the current fiscal biennium. The fiscal impact of this change is unknown.

Part 2: Port Enhancement Zones[83]

North Carolina seeks to incent businesses to create jobs and invest in business property primarily through Article 3J tax credits. A taxpayer's eligibility for a credit and the amount of the credit varies depending upon the county[84] or zone[85] in which the jobs are created or the investments are made. These credits may be combined to offset up to 50% of the taxpayer's State income and franchise tax liability, and as a general rule, unused credits may be carried forward for up to five years.[86]

This act creates a new type of zone eligible for enhanced credits under Article 3J, a "*ports enhancement zone.*" North Carolina has two State ports, the Port of Morehead City and the Port of Wilmington. The Port of Morehead City is located in Carteret County; Carteret County is a tier 3 county. The Port of Wilmington is located in New Hanover County; New Hanover County is also a tier 3 county.

A ports enhancement zone is defined as an area that meets the following conditions:

> Is comprised of one or more contiguous census tracts, census block groups, or both, in the most recent federal census.
>
> All of the area is located within 25 miles of a state port and is capable of being used to enhance port operations.

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[83] House Bill 903 contained the original contents of this provision. HB 903 remains in House Finance at the end of the 1st regular session of the 2011 General Assembly. The provisions of HB 903 were added to this act by an amendment offered in Senate Finance.

[84] The Department of Commerce annually ranks the State's 100 counties based on economic well-being and assigns a tier designation to each. The 40 most distress counties are designated as tier 1, the next 40 are tier 2, and the 20 least distressed are tier 3.

[85] Urban Progress Zones are defined in G.S. 143B-437.09 and Agrarian Growth Zones are defined in G.S. 143B-437.10.

[86] Fifteen-year carry-forwards apply to the credit for investing in real property and 20 carry-forwards exist for taxpayers that invest at least $150 million over a two-year period.

Every census tract and census block group in the area has at least 11% of households with incomes of $15,000 or less.

The defining statute stipulates that the area of the county that is included in one or more port enhancement zones may not exceed 5% of the total area of the county. Upon application of the county, the Secretary of Commerce is directed to make a written determination whether the requested area meets the conditions required for the designation. The Secretary must annually publish a list of all port enhancement zones.

The enhanced credits available to an urban progress zone (UP zone) and an agrarian growth zone (AG zone) will be available to a ports enhancement zone. The enhanced credits available to an UP zone or an AG zone under Article 3J are as follows:

Jobs tax credit. – The threshold for new full-time jobs created to qualify for the tax credit for creating new jobs is the same as for a tier 1 county, five[87] and the amount of the credit is increased by $1,000 per job.[88] If the job is filled by a resident of the zone or a long-term unemployed worker, the credit is increased by an additional $2,000 per job.

Machinery and equipment investment tax credit. – The investment threshold requirement to qualify for the tax credit for investing in business property is the same as a tier 1 county, which is none. The amount of the investment tax credit is also the same as a tier 1 county, 7% of the cost of tangible personal property that is placed in service during the taxable year.[89]

The enhanced credits become effective for taxable years beginning on or after January 1, 2013. The effective date ensures the changes do not have a fiscal impact in this biennium. The fiscal impact of this change is unknown.

Part 3: Encourage Investment to Retain Article 3A Installment[90]

In 2001, the General Assembly created a tax credit under the Bill Lee Act for substantial investment in other real property. To claim the credit for substantial investment in other property, the Secretary of Commerce must make a written determination that the taxpayer is expected to invest at least $10 million in real property at a location within a three-year period and that the location will create at least 200 new jobs within two years of the time that the property is first used in an eligible business. The taxpayer may begin to claim the credit once the property is first used in an eligible business. A taxpayer may not claim both the credit for substantial investment in other property and the credit for investing in central office or aircraft facility property with respect to the same property.

The amount of the credit for substantial investment in other property is equal to 30% of the eligible investment amount and must be taken in installments over a seven-year period. There is no ceiling on the amount of the credit. Any unused credit may be carryforward for 20 years,

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[87] The qualifying job threshold for a tier 2 county is 10; and a tier 3 county is 15.

[88] The amount of the jobs credit in a tier 1 county is $12,500 per job; a tier 2 county is $5,000; and a tier 3 county is $750.

[89] The threshold for a tier 2 county is $1 million and the credit is 5% of the cost of the property that exceeds the threshold. The threshold for a tier 3 county is $2 million and the credit percentage is 3.5%.

[90] Senate Bill 345 contained the original contents of this provision. The bill received a favorable report from the Senate; however, the bill received an unfavorable report in the House Finance Committee. The Senate Finance Committee adopted an amendment to this bill, HB 751, to incorporate a modified version of the contents of SB 345 – the Senate amendment required the taxpayer to retain an employment level of at least 125; the original bill did not contain a minimum employment level.

as opposed to the more standard carryforward period of five years. The Bill Lee tax credits expired for business activities occurring on or after January 1, 2007.

The credit for substantial investment in other property expires if the number of people employed at the location falls below 200. In this case, the taxpayer may not take any remaining installments of the credit but the taxpayer may take the portion of an installment that accrued in a previous year and was carried forward.

This act creates an exception for which a taxpayer may continue to take the remaining installments of the credit for substantial investment in other property even when the number of employees the taxpayer employs at the property falls below 200. Under the law as amended by this act, the taxpayer may continue to claim the remaining installments of the credit if the taxpayer has invested a certain amount in the property within two years of the date the employment fell below 200 and the employment level has not fallen below 125. The amount that must be invested is at least two times the value of the remaining installments of the credit. If the employment level falls below 125, the taxpayer may not take the remaining installments of the credit, regardless of how much the taxpayer has invested in the property

This provision is effective retroactively for taxable years beginning on or after January 1, 2009. Fiscal Research is aware of only one taxpayer impacted by the legislation.[91] The act allows the taxpayer to remain eligible to take five remaining credit installments of $424,000 each. Without the changes made by the act, the taxpayer would become ineligible for these five remaining installments and its tax liability would increase accordingly

Rev Laws Tech, Clarify., & Admin. Chngs.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-330	**SB 267**	**Sen. Clodfelter, Hartsell**

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

OVERVIEW: This act includes several technical, administrative, and clarifying changes to the revenue laws and related statutes.

FISCAL IMPACT: No impact.

EFFECTIVE DATE: Except as otherwise stated in the analysis, this act became effective when the Governor signed it into law on June 27, 2011.

ANALYSIS:

Section	Explanation
Business Tax Changes	
1	Changes the effective date for the exclusion of amenities from general admissions receipts. Prior to February 1, 2009, amenities were excluded

[91] The taxpayer appears to be Vantage Foods located in Lenoir, NC. The company is one of four of The Alex Lee Family of Companies located in North Carolina. The other three are Lowe's Foods Stores, Inc. in Winston-Salem, and Institution Food House, Inc. and Merchant's Distributor's, Inc., which are both located in Hickory, NC.

	from admissions receipts. Effective February 1, 2009, with one day's notice, the Department of Revenue issued a directive providing that amenities would be included in admissions receipts. The Revenue Laws Study Committee recommended, and the General Assembly enacted, a restoration of the prior understanding. The effective date of the legislation was August 1, 2010. Companies that paid the tax with amenities included in the admissions receipts sought a refund of the excess tax paid. The Department denied the refund request because the effective date of the legislative change was August 1, 2010, not February 1, 2009 (the day the directive took effect).
2	Modifies the cigarette excise tax payment statute to accommodate operating procedural changes being implemented by certain cigarette manufacturers and their affiliates. It does not change the manufacturer that is responsible for paying the tax.
3	Repeals an obsolete provision. When the General Assembly enacted the qualified business venture tax credits in 1987, they applied to investments in North Carolina companies and to both corporations and individuals. In 1996, the General Assembly revised the tax credit to apply to all investments because the restriction to North Carolina companies was unconstitutional. In the same act, S.L. 1996-14, ES2, the General Assembly also restricted the tax credit to individuals and pass-through entities. The subsection being repealed is a carry-over from the original law as it applied to holding companies.
4	Provides a definition for development tier one area in the tax credit for research and development. The tax credit amount for research performed in a development tier one area is 3.25%.
5	Repeals an obsolete provision. In S.L. 2010-89, the General Assembly provided an alternative apportionment formula for a corporation that signed a letter of commitment by September 15, 2010, certifying that it planned to invest at least $500 million in private funds to construct a facility in a development tier one area. No company signed such a letter. The General Assembly enacted the provision at the request of Microsoft; Microsoft announced in August that it would be locating in Virginia.
6	Repeals obsolete term. S.L. 2005-395 amended the real estate licensing laws to eliminate real estate salespersons licenses, making all licensed real estate agents real estate brokers as of April 1, 2006.
7	Removes reference to repealed statute. The General Assembly repealed G.S. 105-113.81A in the budget bill in 2009, S.L. 2009-451, as part of the special provision on "*Commerce/Enterprise Funds and Special Funds*".
8	Clarifies the franchise tax base.
9	Specifies the statutory reference.

10	Removes reference to obsolete provision. S.L. 2006-196 combined the statewide and local rates for insurance policies providing fire and lightning coverage and established a new statewide rate of 0.85% for the supplemental tax, effective January 1, 2008. The changes effectively replaced the tax on fire and lightening coverage with an additional tax on property coverage contracts.
Personal Tax Changes	
11	Clarifies that the IRC Update bill applies to the estates of decedents dying on or after January 1, 2011.
12	Makes changes to the provisions in the budget bill regarding the move from federal taxable income to adjusted gross income to ensure the bill does not inadvertently change the existing tax base in ways that were not intended.
13f	Ensures that a taxpayer may not take a double deduction for a 2009 net operating loss claimed on a 2006 return.
14	Reserved.
Sales and Use Tax and Article 5F Tax Changes	
15	Clarifies the original intent of the sales tax refund granted to professional motorsports teams for aviation fuel and tangible personal property that comprises part of the racing vehicle. In the last couple of years, the Department of Revenue has changed its interpretation of how the refund is applied. This section modifies the statutes to allow a related entity that pays the tax on behalf of the team to claim the refund and ensures that the refund only applies to professional motorsports teams that compete in at least 66% of the races sponsored in a race series. There are three race series in a season. The narrowing of the refund's applicability becomes effective when it becomes law; the other changes apply retroactively to the date the General Assembly authorized the refunds. Subsection (a) of this section also corrects a reference in the definition of 'over-the-counter drug' and makes conforming changes related to the change made in Section 17 of the act.
16	Clarifies that an accommodation arranged or provided by a school, camp, or similar entity to a person who pays to attend the school or camp is not subject to sales tax. In the past, the Department of Revenue did not consider summer camps, dorm rooms, or similar types of accommodations to be subject to sales tax. Recently, however, there appears to be some uncertainty. This section clarifies that there should not be a change in the application of the law in regards to these types of entities.

17	Removes the word "wireline" from the term 'prepaid calling service' at the request of the Streamlined Sales Tax Compliance Review and Interpretations Committee. It makes no substantive change in the law. Section 15 of the act made similar changes in the definitional statute.
18	Clarifies that the sales tax exemption for prosthetic devices is for human use, corrects the name of the agency where the Child and Adult Care Food Program is located, and corrects the name of the federal supplemental food program. This section also makes technical changes requested by the Department of Revenue in subdivisions (33a) and (49).
19	Removes geothermal heat pumps from the Energy Star sales tax holiday because consumers are not able to purchase them. Only a contractor can purchase a geothermal heat pump, which the contractor then sells to a consumer through the contractor's business. The holiday does not apply to the purchase of a product for use in a trade or business. The presence of the item in the list raised many questions and frustrated consumers.
20	Corrects the sunset dates of the sales tax refunds for fuel sold to passenger air carriers and motorsports teams. The General Assembly extended these sunsets from January 1, 2011, to January 1, 2013, in S.L. 2010-31. In a subsequent piece of legislation recommended by the Revenue Laws Study Committee, S.L. 2010-166, these refund provisions were reenacted in a new statute dedicated to economic incentive refunds. The later legislation failed to extend the sunset dates as provided in the previously enacted legislation.
21	Clarifies that use tax is payable by an individual on an annual basis for purchases made outside the State for a nonbusiness purpose of digital property and certain services. In 2009, the General Assembly imposed the State and local general rate of sales tax on certain digital goods, such as downloaded music and books. The legislation also made several conforming changes by adding the term "digital property" to a number of other sales tax statutes. Among them, the term "digital property" was added to the statute that sets out when an individual is required to pay use tax on out-of-State purchases. Since digital property was being subjected to sales tax, a corresponding change was made to subject it to use tax if it is purchased out of State. The Department of Revenue is interpreting the statute to exclude digital property and services from the annual use tax reporting requirement. This section clarifies that the "other than" phrase applies only to boats and aircraft. All other tangible personal property, digital property, and taxable services purchased outside the State for a nonbusiness use are subject to the annual reporting requirement for use tax.

22	Removes unnecessary and confusing words. If a datacenter fails to maintain its required levels of investments, it forfeits its incentive and must pay sales tax on its purchases. The statute stated that the sales tax would be calculated "*at the combined general rate*". The words are not necessary and may not correctly reference the right tax rate since the term "combined general rate" does not include the ¼ ¢ local sales tax applicable in some counties and may not accurately reflect the State tax rate in existence at the time of the investment.
23	Provides that a facilitator would not be liable for an over-collection or an under-collection of sales tax or local occupancy tax during the period of January 1, 2011, through April 1, 2011, as the result of the new collection and remittance obligations imposed under Section 31.6 of S.L. 2010-31 as long as the facilitator made a good faith effort to comply with the law and collect the proper amount of tax. During the 2010 Session, the General Assembly established new sales and use tax reporting and remittance obligations on "facilitators," which are entities that enter into a contract with the providers of accommodations to market and collect payment for accommodation rentals. An example of a facilitator is an online travel company, such as Expedia or Travelocity.
24	Gives effect to the changes the General Assembly made last session to the requirements for a datacenter to qualify for the 1% excise tax on the machinery and equipment it purchases. In S.L. 2007-323, the General Assembly created a tax incentive for the construction of datacenters by exempting the purchase of equipment from sales tax and, in its place, substituting the 1% excise tax. To qualify, a taxpayer had to invest $300 million in a NC datacenter over a five-year period. In S.L. 2010-91, the General Assembly reduced the investment threshold from $300 million to $225 million and also allowed taxpayers investing $225 million in one datacenter and $75 million in a second datacenter to pay the reduced rate on purchases of equipment for both datacenters. The modification allowed a datacenter to meet its investment threshold for the first facility at a lower threshold amount because the project was completed at a lower cost than originally estimated. It also provided that the initial investment amount would continue to be realized through investment in a second facility. The purpose of the legislation was to preserve the tax benefits for taxpayers who responded to the State's incentive offer in 2007 but whose investment expectations had changed. The 2010 legislation was generally effective July 1, 2010; the Department of Revenue questioned the applicability of the changes as they applied to datacenters already under construction. The Department reasoned that the language could be read to require a taxpayer to forfeit the reduced rate on all datacenter purchases made before July 1, 2010, even if the taxpayer met the investment threshold amounts. This

	section clarifies that the changes made in 2010 apply to all datacenter purchases made to date.
25	Clarifies that the amount of credit allowed for tax paid to another state is the amount of tax due and paid to that state.
26	Clarifies that a refund of tax allowed under G.S. 105-164.14, 105-164.14A, and 105-164.14B are not an overpayment of tax entitled to interest.
27	Clarifies the effective date of a tax change for services. North Carolina has been notified that it is out of compliance with the Streamlined Sales Tax Agreement on this issue because the Governing Board reads the current law to mean that different rates could apply to items billed in arrears and items billed in advance; the change is needed to comply with the Agreement.
28	Changes the term 'certificate of resale' for 'certificate of exemption' to conform to the name on the certificate.
29	Clarifies that for purposes of digital property, the sale is sourced to the place where the purchaser of the property takes possession or makes first use of the property, whichever comes first. North Carolina has been notified that it is out of compliance with the Streamlined Sales Tax Agreement on this issue; the change is needed to comply with the Agreement.
Excise Tax on Conveyances	
30	Clarifies the refund process for the deed stamp tax.
General Administration Tax Changes	
31	Updates the reference to NAICS and places the definition in the statute applicable to most of Chapter 105. NAICS is the North American Industry Classification System adopted by the US Office of Management and Budget. It is updated every five years. Makes a conforming change to the term "information technology and services" to reflect the changes from the 2002 NAICS to the 2007 NAICS.
32	Clarifies that the higher penalty for failure to obtain a license under the motor fuel statutes only applies after the taxpayer has received written notification from the Department of Revenue to obtain the requisite license.

33	Reconciles two conflicting provisions concerning whether the identity of certain taxpayers is public information. This section also makes conforming changes. The taxpayers affected are those who bring a contested case action at the Office of Administrative Hearings to obtain a review of an assessment or a denial of a refund by the Department of Revenue. Previously, G.S. 150B-31.1(e) stated that the record, proceedings, and decision in a contested case are confidential until the final decision is issued. The Secretary of Revenue makes the final decision and, once that decision issued, the records with the taxpayer name is public. However, G.S. 105-256(a)(9) required the Secretary of Revenue to publish the final decision in a contested case in a format that redacts identifying information. The requirement to redact the identifying information serves no purpose because once the decision is published, the record in the contested case proceeding becomes public in an unredacted form under G.S. 150B-31.1. Subsection (a) reconciles these provisions by amending G.S. 105-269(a)(9) to delete the requirement that the Secretary redact identifying taxpayer information when publishing final decisions. Subsection (b) makes a conforming change to the secrecy statute, G.S. 105-259, to change the word "report" to "publication" to ensure that the final decisions are included within the current exception for reports. G.S. 150B-31.1 and G.S. 105-256(a)(9) were both enacted in 2007 in Senate Bill 242, S.L. 2007-491. Under prior law, the Tax Review Board reviewed administrative decisions of the Secretary and made a decision, called an order, after the review. Orders of the Tax Review Board were published in the North Carolina Register, as required by G.S. 150B-21.17(a)(5),and were not redacted. S.L. 2007-491 revised the procedure for the review of contested tax cases and, as part of the revisions, eliminated the Tax Review Board. Subsection (c) makes a conforming change and repeals the obsolete requirement in G.S. 150B-21.17(a)(5) to publish orders of the Tax Review Board in the North Carolina Register.
34	Clarifies that a waiver of a statute of limitations must be executed before the statute of limitations expires.
35	Repeals an obsolete reporting provision. The reporting provisions were consolidated into a single statute in S.L. 2010-166.
36	Conforms the sunset provisions of miscellaneous provisions associated to the tax credit for recycling oyster shells. The General Assembly extended the sunset on this credit from January 1, 2011, to January 1, 2013, in S.L. 2010-147.

37	Ensures that the definition of 'person' for purposes of the Setoff Debt Collection Act of Chapter 105A is the same as the definition of 'person' for tax purposes under Chapter 105.
38	Deletes a statute concerning the procedure for Department initiated refunds of sales and use tax because the procedure applicable for all Department initiated refunds is in G.S. 105-241.7.
39	Reserved.
Property Tax Changes	
40	Clarifies the postmark rule for property taxes on registered motor vehicles. The provision is the same as the rule for other property tax payments and is the same as current administrative practice.
41	Clarifies that the definition of "public service company" in the property tax statutes does not include providers of mobile telecommunication service.
42	Corrects errors in the effective date section of the legislation regarding the change in the collection of motor vehicle property taxes.
43-44	Reserved.
Local Government Sales and Use Tax Changes	
45	Modernizes the local sales tax base to conform to the State sales tax base for items taxed at the general rate of tax. This change will remove the need to amend the local sales tax statute whenever an item is added to the State sales tax base and taxed at the general rate of tax. It effectively includes digital products in the local sales tax base, as intended by the General Assembly.
Miscellaneous Changes	
46	Removes the sunset from the provision that allows the Codifier of Statutes to renumber the subdivisions in the special license plates statute in sequential and alphabetical order. Changes the name of the Division of Legislative Drafting and Codification to Legislative Services Office, to conform to the changes made in S.L. 2011-97.
47	Clarifies the fees that should be credited to the Insurance Regulatory Fund.
48-49	Reserved.
Effective Date	
50	Except as otherwise provided, the act became effective when the Governor signed it into law on June 27, 2011.

Extend Sunsets.

Session Law	Bill #	Sponsor
S.L. 2011-345	**SB 436**	**Senator Hartsell**

AN ACT TO EXTEND THE SALES TAX REFUND ALLOWED TO A JOINT GOVERNMENTAL AGENCY CREATED TO OPERATE A CABLE TELEVISION SYSTEM FOR ONE YEAR.

OVERVIEW: This act extends for one year the sales tax refund allowed to a joint governmental agency created to operate a cable television system.

FISCAL IMPACT: This act reduces General Fund availability by $25,000 for the 2011-12 fiscal year and local revenues by $5,000 per fiscal year. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2011 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective when the Governor signed it into law on June 27, 2011.

ANALYSIS: Last session, the General Assembly allowed cities that jointly operate a cable television system to obtain a refund of State and local sales and use tax paid by the entity on purchases made between July 1, 2007, and June 30, 2010.[92] This act extends the refund for one year, for purchases made through June 30, 2011.

The only entity that fits this description is MI Connection. MI Connection is a locally owned and operated cable and Internet system serving the towns of Mooresville, Davidson and Cornelius in the counties of Mecklenburg and Iredell. The municipalities have created a joint agency through an interlocal agreement pursuant to G.S. 160A-462 to operate a cable television system. A cable television system is one of the listed systems that a municipality has the authority to operate as a public enterprise under Article 16 of Chapter 160A of the General Statutes.

Under G.S. 105-164.14(c) a city may obtain a sales tax refund of the purchases it makes. Under that authority, a city that operates a cable television system may obtain a sales tax refund; MI Connection was not allowed a refund under that subsection because it was operated as a joint venture, rather than by the cities themselves.

Increase In Rem Foreclosure Fee.

Session Law	Bill #	Sponsor
S.L. 2011-352	**SB 537**	**Senator Hartsell**

AN ACT TO INCREASE THE IN REM FORECLOSURE FEE.

OVERVIEW: This act increases the amount of the charge for administrative costs that may be added to the tax due as part of the costs of the action in an in rem foreclosure proceeding for delinquent tax.

FISCAL IMPACT: Although no data is available on the number of in rem foreclosure proceedings in the state, this method of foreclosure has become more common in recent years. The $50 fee that is currently charged is not adequate to recover administrative costs to the

[92] S.L. 2010-153.

taxing unit, particularly when a clear chain of title has to be established. The $250 fee would more closely reflect the actual administrative costs associated with in rem foreclosures. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2011 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The act became effective July 1, 2011, and applies to in rem foreclosure proceedings commenced on or after that date.

ANALYSIS: This act increases from $50 to $250 the charge for administrative costs that may be added to the tax due as part of the costs of the action in an in rem foreclosure proceeding for delinquent tax[93] due. The current administrative cost of $50 has not been increased since it was first allowed in 1987. The in rem procedure is an expedited procedure that permits a taxing unit to docket a judgment against the property in State court and proceed with a foreclosure sale within three months to two years after the judgment is docketed. In an in rem procedure, the costs of mailing and publication plus a $50 charge to defray administrative expenses may be added to the amount of taxes due; if an attorney is used, the attorney fee is paid by the taxing unit and may not be added to the judgment as part of the costs of the action. Much of the administrative time required for an in rem foreclosure is spent researching the property's chain of title.

Extend Time For Site Of Low/Mod. Inc. Housing.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-368	**HB 417**	**Representative McGrady**

AN ACT TO EXTEND THE TIME PERIOD FOR HOLDING REAL PROPERTY AS A FUTURE SITE FOR HOUSING FOR LOW- OR MODERATE-INCOME INDIVIDUALS AND FAMILIES.

OVERVIEW: This act extends from 5 years to 10 years the maximum time period that real property owned by a nonprofit organization as a future site for low or moderate income housing may be exempted from taxation.

FISCAL IMPACT: This act affects property taxes imposed by local governments.

EFFECTIVE DATE: This act is effective for taxes imposed for taxable years beginning on or after July 1, 2011.

ANALYSIS: Real property owned by a nonprofit organization providing housing for individuals or families with low or moderate incomes is exempt from property taxation if the owner is not organized or operated for profit and it is actually and exclusively occupied and used. This act provides that real property held for low or moderate income housing may be exempted from taxation for a maximum of 10 years. Under prior law, real property held for low or moderate income housing was exempted from taxation for a maximum of five years. The taxes otherwise due are a lien on the property. The taxes are carried forward to the next year as deferred taxes and are due if the property loses eligibility because of a disqualifying event. A disqualifying event occurs when the property is not used for low or moderate income housing.

[93] Taxes become delinquent when interest begins to accrue on January 6 of the year in which the taxes were levied.

Forced Combinations.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-390	**HB 619**	**Rep. Howard, McLawhorn, Carney, Ingle**

AN ACT TO SPECIFY THE SECRETARY OF REVENUE'S AUTHORITY TO ADJUST THE NET INCOME OF A CORPORATION OR TO REQUIRE A CORPORATION TO FILE A COMBINED RETURN.

OVERVIEW: This act changes the Secretary of Revenue's authority to adjust the income of a multistate corporation by requiring it to file a combined return when the Secretary determines the corporation conducts its business in a way that fails to accurately reflect its income attributable to North Carolina.[94] Under current law, the Secretary may redetermine the net income of a corporation if the Secretary finds a report by the corporation does not reflect its true earnings from its business carried on in this State. Under the law effective for taxable years beginning on or after January 1, 2012, the Secretary may only make this redetermination if the Secretary finds the corporation fails to accurately report its State net income through the use of transactions that lack economic substance or are not at fair market value. The act also directs the Revenue Laws Study Committee to review the legislation and recommend any needed changes, as well as to determine whether the provisions of the new law should apply to pending assessments.[95]

FISCAL IMPACT: The Department of Revenue believes the changes made by the act will have a significant negative fiscal impact because it may affect agreements the Department has entered into with multistate corporate taxpayers through its resolution initiatives. [96] The Fiscal Research Division noted the act will not increase or decrease revenues above the baseline budgeted amount because the biennial consensus revenue forecast does not include in the tax base any agreements the Department may have entered into with taxpayers. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2011 Session. Available in the Legislative Library.)*

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[94] The Senate removed the original contents of House Bill 619, which were included in S.L. 2011-145, the Current Operations and Capital Improvements Appropriations Act of 2011, and replaced them with the provisions of this act. The House concurred in the Senate Finance Committee Substitute with its four unengrossed amendments.

[95] The Senate Finance Committee Substitute applied to pending assessments. Amendment #2 made the act prospective only and directed the Revenue Laws Study Committee to recommend whether the provisions of the act should apply to pending assessments. The amendment intended to replace Section 7 of the third edition, which extended the time the Department of Revenue had to issue a final determination, with the Revenue Laws Study. However, because of an engrossment error, the act retained that Section 7, which is harmless, as well as a second Section 7 that directs the study. The amendment would have removed the extension because it was no longer needed since the act is effective prospectively and does not apply to pending assessments.

[96] The Department of Revenue believes the changes made by Amendments #1 and #3 may have a significant fiscal impact. Amendment #1 prohibits the Secretary from making adjustments that limit a corporation's options for reporting royalty payments; Amendment #3 prohibits a life insurance company or an insurance company subject to tax under Section 831 of the Code from being included in a combined return. The Revenue Laws Study Committee plans to consider these changes as part of its review of the legislation.

EFFECTIVE DATE: The act becomes effective January 1, 2012, and applies to proposed assessments for taxable years beginning on or after January 1, 2012.[97]

ANALYSIS: North Carolina is a single-entity filing state, meaning that a multistate corporation must determine its State net income as if it filed a separate return for each subsidiary corporation for federal income tax purposes. G.S. 105-130.14 prohibits a corporation from filing a combined return in North Carolina unless specifically directed by the Secretary of Revenue. Under G.S. 105-130.6, the Secretary can require a corporation to file a combined return with other parent, subsidiary, or affiliated corporations when the Department of Revenue believes the corporation's net income attributable to this State is not accurately reflected on its separate filing return.

A corporation directed to file a combined return has 60 days to file the return before being subject to penalties unless the taxpayer has requested a hearing on the tax liability used as the basis for the penalty. The Secretary was directed in 2010 to adopt rules that describe when the Secretary would require the filing of a combined return.[98] A corporation must file a combined return when the rule adopted by the Department requires or, after a written request from the corporation, the Secretary provided written advice to the corporation stating that the Secretary will require a combined return.

The act repeals G.S. 105-130.6 and replaces it with G.S. 105-130.5A, which provides the following:

> If the Secretary has reason to believe a corporation's business conduct causes it to inaccurately report net income attributable to its business in North Carolina, the Secretary may give notice to and require any information necessary from the corporation to determine whether its intercompany transactions have economic substance[99] and are at fair market value between affiliated members.[100] The corporation has 90 days to comply.
>
> If the Secretary reviews the provided information and finds as fact that the intercompany transactions lack economic substance or were not at fair market value, the Secretary may redetermine the State net income of the corporation by (i) adjusting the intercompany

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[97] The Department of Revenue has requested clarification of the effective date. The repeal of G.S. 105-130.6 on January 1, 2012, appears to leave a window in which no law exists regarding the Secretary's authority to determine the State net income of a corporation who fails to accurately reflect its income attributable to North Carolina. A clearer effective date would have been one that made the act effective for taxable years beginning on or after January 1, 2012.

[98] The Department did not adopt any rules in this area.

[99] G.S. 105-130.5A(f), as enacted by this act, defines economic substance to require one or more transactions that have both reasonable business purposes and economic effects. Reasonable business purposes and economic effects include any material benefit other than tax benefits, excluding tax benefits consistent with legislative intent. A showing that a transaction has economic effect beyond tax benefit may be satisfied by demonstrating material business activity of the entities involved. Centralized cash management of an affiliated group, alone, is not evidence of an absence of economic substance, and a financial accounting benefit is not a reasonable business purpose, alone, if the origin is a reduction of income tax.

[100] An affiliated group is two or more corporations or noncorporate entities in which more than 50% of the voting stock, including ownership interests for noncorporate entities, of each member is directly or indirectly owned or controlled by a common owner or owners, excluding (i) corporations not required to file a federal income tax return; (ii) certain insurance companies; (iii) certain tax-exempt corporations; (iv) S corporations; (v) foreign corporations under section 7701 of the Code; (vi) a partnership, LLC, or other entity not taxed as a corporation; and (vii) a corporation with at least 80% of its gross income from all sources in the tax from active foreign business income.

transactions to accurately reflect State net income or (ii) requiring the corporation to file a combined return for all members of its affiliated group conducting a unitary business.[101] If either option is utilized, the Secretary must provide the corporation with a written statement containing details of the rationale supporting the findings of fact as to inaccurate reporting and as to the Secretary's proposed computational method of income.

If the Secretary finds as fact that a combined return is required, the Secretary may require the submission of a combined return within 90 days of written notice. The submission does not act as an admission of liability, and the Secretary or corporation may propose a combination of fewer members.[102]

In determining whether transactions between members of the affiliated group of entities are at fair market value, the Secretary must apply the standards contained in Section 482 of the Code.

If a combined return is required, the combined net income of the corporation and affiliated members must be apportioned in a way that fairly reflects the current apportionment formula applicable to the corporation and each included affiliated member in determining State income tax.

Properly required returns not timely submitted result in penalties.

A corporation may request in writing specific advice regarding whether a redetermination of net income or a combined return would be required under listed facts, and the Secretary may request additional information. Advice must be provided within 120 days of receipt of the request. The Secretary may charge a fee for providing advice, which are credited to an account in the Department and do not revert to the General Fund. The fee must be between $100 and $5,000 unless waived by the Secretary.

The Secretary and corporate taxpayers may extend the time limits contained in G.S. 105-130.5A, by mutual agreement.

Appeals of the Secretary's determination are to the Office of Administrative Hearings. The administrative law judge holds a de novo review of the following issues:

- Whether the separate income tax returns fail to report State net income property due to transactions that lack economic substance or are not of fair market value between affiliated members.
- Whether the Department's redetermination of net income is appropriate to properly determine the corporation's income attributable to North Carolina.
- Where a combined return is required, whether adjustments other than requiring the combined return are adequate to determine State net income.

[101] This authority exists even if all members of the affiliated group are not doing business in the State.
[102] Senate Amendment #4 increased the time from 60 days to 90 days. Likewise, the amendment imposed a 90-day requirement on the Department of Revenue to provide the taxpayer with a written statement of facts after a proposed assessment.

Tax Credits for Children with Disabilities.

Session Law	Bill #	Sponsor
S.L. 2011-395	**HB 344**	**Rep. Stam, Randleman, Jordan, Jones**

AN ACT TO ALLOW AN INDIVIDUAL INCOME TAX CREDIT FOR CHILDREN WITH DISABILITIES WHO REQUIRE SPECIAL EDUCATION AND TO CREATE A FUND FOR SPECIAL EDUCATION AND RELATED SERVICES.

OVERVIEW: This act creates a new income tax credit for tuition and special education and related services expenses for a taxpayer's eligible dependent child with a disability who is enrolled in a private school or a public school where tuition is charged for the eligible dependent child's enrollment. The act also creates a Fund for Special Education and Related Services with the monies to be used for special education and related services for children with disabilities. The act requires the Department of Revenue to report on the administration of the credit.

FISCAL IMPACT: Effective for tax years beginning on or after January 1, 2011 and semesters occurring on or after July 1, 2011 the legislation is expected to reduce General Fund availability by $1.4 million in fiscal year 2011-12, and increase General Fund availability in future years. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2011 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The new tax credit is effective for taxable years beginning on or after January 1, 2011, and applies to semesters for which the credit is claimed beginning on or after July 1, 2011. The Fund is effective January 1, 2011, but transfers to the Fund will not be made before the 2012-2013 fiscal year.

ANALYSIS: This act creates a new individual income tax credit of up to $3,000 per semester for tuition and special education and related services expenses for a taxpayer's eligible dependent child with a disability who is enrolled in a nonpublic school or a public school where tuition is charged for the eligible dependent child's enrollment.[103]

Credit. – A taxpayer is allowed an education expenses tax credit for tuition and special education and related services expenses for each "eligible dependent child" who is a resident of this State and who is enrolled for one or two semesters during the taxable year in grades

[103] Approximately five states provide programs for students with disabilities to attend private schools:

- Florida - The John M. McKay Scholarships Program for Students with Disabilities gives parents a voucher to send their child to a private school or another public school of their choice.
- Utah - The Carson Smith Special Needs Scholarship Program awards scholarships to students with disabilities who attend a private school, both secular and non-secular.
- Ohio - The Special Education Pilot Project, also known as the Autism Scholarship Program, is a scholarship awarded to parents of autistic children for services at a public or nonpublic special education program, which includes tuition at a private school.
- Oklahoma - Oklahoma enacted the Lindsey Nicole Henry Scholarship for Children with Disabilities in 2010. The amount of the scholarship would be either the private school's tuition or the amount of state and local money that would be given to the school system where the student is enrolled, whichever is less.
- Georgia - Georgia enacted the Special Needs Scholarship Act in 2007, creating a program which allows children with special needs to attend the public or private school that best meets their educational needs.

Kindergarten-12 at either a nonpublic school or at a public school for which tuition is charged. The credit amount is $3,000 per semester, up to two semesters a year for a maximum of $6,000 for a full academic or taxable year. For home schools, the credit is equal to the amount the taxpayer paid for special education and related services expenses not to exceed $3,000 per semester.

An eligible dependent child must meet all of the following criteria:

> Is a child with a disability who requires an individualized education program (IEP) under Article 9 of Chapter 115C of the General Statutes[104] and the federal Individuals with Disabilities Education Improvement Act (IDEA).[105] The child must be reevaluated every 3 years by a local educational agency to verify that the child continues to be a child with a disability.
>
> Receives special education or related services on a daily basis.
>
> Is a child for whom the taxpayer is entitled to deduct a personal exemption under section 151(c) of the Code for the taxable year.

For the initial eligibility for the tax credit during the first five years that the credit is available, the eligible dependent child must have been enrolled for at least the preceding two semesters in a public school or receiving special education or related services through the public schools as a preschool child with a disability. This initial eligibility requirement is reduced to one semester beginning for taxable years on or after January 1, 2016, and applies to semesters for which the credit is claimed beginning on or after July 1, 2016.

For purposes of this credit, there are two semesters during each taxable year with the spring semester being the first 6 months of the taxable year and the fall semester being the second six months of the taxable year. An eligible dependent child is considered to have been enrolled in a school for a semester if the eligible dependent child is enrolled in that school for more than 70 days during that semester.

The tax credit is not refundable but any unused portion of the credit may be carried forward for three succeeding years.

Disqualification. – A taxpayer is not qualified for the education expenses tax credit for any semester if the taxpayer's otherwise eligible dependent child meets any of the following conditions:

> Was placed in a nonpublic school or facility by a public agency at public expense.
>
> Spent any time enrolled as a full-time student taking at least 12 hours of academic credit at a postsecondary educational institution.
>
> Was 22 years of age or older during the entire semester.
>
> Graduated from high school prior to the end of the semester.

Reduction. – The amount of the education expenses tax credit is reduced for any semester in which the eligible dependent child spent any time enrolled in a public school. The amount of the reduction is equal to the percentage of the semester that the eligible dependent child was enrolled in a public school.

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[104] Education of Students with Disabilities.

[105] 20 U.S.C. § 1400 et seq.(2004), as amended.

Documentation. – To substantiate the credit, a taxpayer must provide all of the following information to the Department of Revenue, if requested by the Secretary of Revenue:

The name, address and social security number of each eligible dependent child for whom the credit is claimed and the name and address of the school or schools in which the eligible dependent child was enrolled in and attended for more than 70 days of each semester.

A certification that there were no disqualifying factors.

The name of the local school administrative unit in which the eligible dependent child resides.

The amount of the tuition paid to a public school for each semester the eligible dependent child was enrolled in and attended that public school.

The eligibility determination that the eligible dependent child is a child with a disability who requires special education and related services.

A listing of the tuition and special education and related services expenses on which the education expenses tax credit is based.

For home schools, a listing of the special education and related services expenses on which the education expenses tax credit is based.

Fund for Special Education and Related Services. – The act also establishes a Fund for Special Education and Related Services (Fund). At the end of each fiscal year, the Secretary of Revenue must transfer an amount equal to $2,000 multiplied by the number of education expenses tax credits taken during the fiscal year to the Fund from the net individual income tax collections. The Fund is a special revenue fund under the control and direction of the State Board of Education. Interest and other investment income earned by the Fund accrue to it and monies in the Fund do not revert. The revenue in the Fund may only be used for special education and related services for children with disabilities. In addition, the monies in the fund must be used to reimburse local educational agencies for conducting reevaluations for continued eligibility and developing revised individualized education programs for children with disabilities.

Report. – The Department of Revenue must report to the Revenue Laws Study Committee and the Joint Legislative Education Oversight Committee on the administration of the education expenses tax credit by October 1, 2013. The report must include all of the following:

The number and amount of education expenses tax credits taken.

Concerns relating to the administration of the education expenses tax credits or taxpayer compliance.

Any other matter the Department wishes to address with respect to the education expenses tax credit.

The remainder of this act (Sections 4A, 5, and 5A) make necessary budget adjustments to the 2011 Appropriations Act[106] needed for the implementation of this act.

[106] S.L. 2011-145.

2010

Modify Renewable Energy Property Credit.

Session Law	*Bill #*	*Sponsor*
S.L. 2010-4	**SB 388**	**Senator Clodfelter**

AN ACT TO REMOVE CERTAIN GRANTS MADE UNDER THE AMERICAN RECOVERY AND REINVESTMENT TAX ACT FROM THE DEFINITION OF PUBLIC FUNDS FOR WHICH A CREDIT FOR INVESTING IN RENEWABLE ENERGY PROPERTY IS NOT AVAILABLE.

OVERVIEW: This act amends the credit for investing in renewable energy property to allow the credit when the cost of the property was provided by grants made under the American Recovery and Reinvestment Tax Act of 2009.

FISCAL IMPACT: No fiscal impact.

EFFECTIVE DATE: The act is effective January 1, 2009, and applies to renewable energy property placed into service on or after that date.

ANALYSIS: North Carolina allows a tax credit for investing in renewable energy property. The credit is equal to 35% of the cost of the property and may be taken against the franchise tax, income tax, or gross premiums tax. The credit applies to the following machinery and equipment or real property:

Biomass equipment that uses renewable biomass resources[1] for biofuel production of ethanol, methanol, and biodiesel; anaerobic biogas production of methane using agricultural and animal waste or garbage; or commercial thermal or electrical generation from renewable energy crops or wood waste materials.

Hydroelectric generators.

Solar energy equipment.

Wind equipment.

Geothermal heat pumps and geothermal equipment.

In the case of renewable energy property that services a single-family dwelling, the credit must be taken for the taxable year in which the property is placed in service. For all other renewable energy property, the credit must be taken in five equal installments, beginning with the taxable year in which the property is placed in service. The maximum amount of the credit is based upon the type of property serviced.

The renewable energy tax credit is not allowed to the extent the cost of the renewable energy property was provided by public funds. This act removes certain federal grants from the definition of "public funds" in the statute. This change allows property funded with these grants to qualify for the credit, placing renewable energy projects on the same footing that they would

[1] Renewable biomass resources are organic matters produced by terrestrial and aquatic plants and animals, such as standing vegetation, forestry and agricultural residues, landfill wastes, animal wastes, and spent pulping liquor.

have been had the recession not greatly reduced potential investors' participation in the projects.

Section 1603 of the American Recovery and Reinvestment Tax Act of 2009 provides eligible taxpayers that develop renewable energy projects a grant equal to up to 30% of the basis of property used to produce electricity from wind energy, closed-loop biomass, open-loop biomass, geothermal, landfill gas, trash combustion, incremental hydropower, marine and hydrokinetic energy, fuel cell property, solar property, and small wind property. Grants of 10% are available for geothermal property that is not eligible for the 30% rate, qualified microturbines, combined heat and power property, and geothermal heat pumps. The property must be placed in service during 2009 or 2010, or after 2010 but before the credit termination date for such property if construction for the property began during 2009 or 2010.

The grant program was enacted, in part, to help the investment market for renewable energy projects. Developers of renewable energy projects often seek investors that are allocated a portion of the income, gains, losses, deductions and tax credits of the project. In the current economic environment, potential tax investors may not be paying federal income taxes and therefore may be reluctant to make these investments. The creation of a grant program removes this obstacle by permitting developers to obtain a federal subsidy by means of a government grant instead of a tax credit.[2]

Appropriations Act of 2010.

Session Law	*Bill #*	*Sponsor*
S.L. 2010-31	**SB 897**	**Senator Dannelly**

AN ACT TO MODIFY THE CURRENT OPERATIONS AND CAPITAL IMPROVEMENTS APPROPRIATIONS ACT OF 2009 AND FOR OTHER PURPOSES.

OVERVIEW: Part 31 of S.L. 2010-31 provides tax and administrative relief to small businesses, extends various economic development incentives, incorporates four tax proposals recommended by the Revenue Laws Study Committee, and clarifies the application of tax penalties in cases of forced consolidation.

The act provides the following tax relief to small businesses:

> It extends the five-year carryback for net operating losses sustained in 2009. (Section 31.1)
>
> It provides a refundable income tax credit to small business taxpayers whose gross receipts for the taxable year are less than $1 million. The credit amount is equal to 25% of the amount of the unemployment insurance contributions the taxpayer paid during the calendar year on wages paid to an individual. (Section 31.1A)
>
> It decreases the number of retailers required to submit a pre-payment of 65% of the amount of sales tax revenue to be remitted for the following month by changing the threshold for this payment schedule from $10,000 to $15,000, effective October 1, 2010, and from $15,000 to $20,000, effective October 1, 2011. (Section 31.3)

[2]AMERICAN RECOVERY and REINVESTMENT ACT of 2009: *Law, Explanation and Analysis,* 200 (CCH 2009).

The act provides administrative relief to small businesses by stipulating that the first annual report of a limited liability company (LLC) is due April 15 following its year of organization. (Section 31.4)

It contains the following provisions to encourage economic development:

It reserves $9.8 million for commerce business recruitment initiatives.[3]

It extends the sunset on the following expiring tax credits and refunds: (Section 31.5)

The tax credit for mill rehabilitation.

The tax credit for qualified business investments.

The sales tax refund for air passenger carriers.

The sales tax refund for motorsports aviation fuel.

It contains the following tax proposals recommended by the Revenue Laws Study Committee:

It updates the reference to the Internal Revenue Code used in defining and determining certain State tax provisions from May 1, 2009, to May 1, 2010. By doing so, North Carolina conforms to the changes made by five federal acts. The bill does not conform to the 5-year carryback for net operating losses (NOL) available to large businesses. (Section 31.1)

It establishes new sales and use tax and local occupancy tax reporting and remittance obligations on a person who enters into a contract with a provider of transient accommodations to facilitate the rental of an accommodation and who collects payment for the rental. (Section 31.6)

It extends the admissions tax to the Internet resale of tickets by a person engaged in the business of reselling and restores the Department of Revenue's pre-2009 interpretation of the admissions tax statute to exclude from tax charges for amenities that are bundled with a ticket purchase. (Section 31.7)

It directs the Department of Revenue to give taxpayers ample notice when it issues an interpretation that revises a prior interpretation by expanding the scope of a tax or otherwise increasing the amount of tax due. (Section 31.7A)

It improves the tax and debt collection process of the Department of Revenue by expanding the use of the Setoff Debt Collection Act, authorizing the use of electronic process for sending notice of garnishment, providing for a data match between the Department and financial institutions holding accounts of delinquent taxpayers, and expanding the Statewide Accounts Receivable Program. (Section 31.8)

It applies retroactively a tax law change enacted last session. S.L. 2009-422 excluded from a corporation's franchise tax base all billings in excess of costs, effective for taxable years beginning on or after January 1, 2010. This provision would apply the change retroactively to 2007. (Section 31.9)

Lastly, it provides that a taxpayer may not be assessed a penalty if the taxpayer pays the tax due within the stated period of time. (Section 31.10)

FISCAL IMPACT: See ANALYSIS. *(For a more complete fiscal analysis, see NC 2010 Legislative Session Budget and Fiscal Policy Highlights. Available online:*

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[3] See S.L. 2010-89, 2010-91, 2010-147, and 2010-167.

http://www.ncleg.net/fiscalresearch/highlights/highlights_pdfs/2010_Session_Highlights.pdf)

EFFECTIVE DATE: Except as otherwise noted, the act became effective when the Governor signed it into law on June 30, 2010.

ANALYSIS: Part XXXI of The Current Operations and Capital Improvements Appropriations Act of 2010 made the following tax law and related changes.

IRC Update. – Section 31.1 updates the reference to the Internal Revenue Code used in defining and determining certain State tax provisions from May 1, 2009, to May 1, 2010.[4] *However, the act does not conform to the five-year carryback of net operating losses incurred by large businesses. This section of the act became effective when the Governor signed it into law on June 30, 2010. The estimated loss to the General Fund for fiscal year 2010-11 is $7.7 million.*

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 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.

This section conforms North Carolina income tax law to the Internal Revenue Code as of May 1, 2010.[7] This change allows North Carolina taxpayers to take advantage of two business tax benefits that are also available at the federal level and simplifies tax reporting because a taxpayer will not need to account for differing federal and State treatment of the same asset. The two benefits are:

> ***Increased expensing limits*** – It extends for one year the increased expensing limit under Section 179 of the Internal Revenue Code.[8] Section 179 allows the expensing of the

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[4] Recommended by the Revenue Laws Study Committee, SB 1183; HB 1829. House Finance removed the IRC Update provisions from HB 1829 and replaced them with various renewable energy incentives (See S.L. 2010-167).

[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."

[7] The act incorporates tax changes made by five federal acts: the Worker, Homeownership, and Business Assistance Act (WHBA), P.L. 111-92; Acceleration of Income Tax Benefits for Haiti Relief, P.L. 111-126; the Patient Protection and Affordable Care Act, P.L. 111-148; the Health Care and Education Reconciliation Act, P.L. 111-152; and the Hiring Incentives to Restore Employment Act (HIRE), P.L. 111-147.

[8] The federal HIRE Act of 2010 extended the 2008 and 2009 expense limit of $250,000 with a phase-out at $800,000 for the 2010 tax year. Prior to the Emergency Economic Stabilization Act of 2008 (EESA), the deduction was limited to $128,000 of the cost of the property with a phase-out at $510,000. EESA temporarily increased the deduction limit and the phaseout through 2008. The American Recovery and Reinvestment Act of 2009 (ARRA) extended the temporary increase through 2009.

purchase price of some business assets[9] in the year of purchase rather than taking depreciation[10] throughout the life of the asset. In other words, expensing trades a smaller yearly deduction over time for a larger deduction in year one. The cost of conforming to this change is approximately $1.2 million in fiscal year 2010-2011.

Five-year carryback period for NOLs – It extends the five-year carryback period for NOLs established under the *American Recovery and Reinvestment Act of 2009* (ARRA), but it does not expand the scope of the relief beyond small businesses, which Congress provided for in the *Worker, Homeownership, and Business Assistance Act of 2009* (WHBA).

In general, NOLs may be carried back and deducted against taxable income in the two tax years before the NOL year, and then carried forward and applied against taxable income for up to 20 years after the NOL year. Under the ARRA, eligible small businesses were allowed to carry back 2008 NOLs for three, four, or five years, instead of the normal two years. An eligible small business is a corporation or partnership with less than $15 million in gross receipts for the tax year in which the loss arose. As part of the WHBA, Congress not only extended this benefit for an additional year, but also expanded the scope of the benefit by removing the small business limitation. The current federal relief is applicable to any taxpayer with business losses, except those that received payments under the Troubled Asset Relief Program. The relief also applies to a loss from operations of a life insurance company.

This section conforms to the one-year extension for small businesses only. Since North Carolina does not allow NOL for corporate taxpayers, conformity to this provision applies only to individual filers. The cost of conforming to this change is approximately $6.5 million in fiscal year 2010-2011.

This section does not conform to the five-year carryback of NOL for other businesses. It requires these larger businesses to add back for purposes of determining their State taxable income any NOL deductions claimed on their federal returns for 2008 or 2009 losses. Then, for taxable years 2011 through 2013, the taxpayer may deduct from federal taxable income one-third of the NOL absorbed on the taxpayer's 2003, 2004, 2005, and 2006 federal returns.[11]

Conformity to the Internal Revenue Code also allows North Carolina taxpayers the following tax benefits:

DOD Homeowner's Program. – Provides that payments made under the Department of Defense Homeowners Assistance Program to certain military and civilian employees in connection with base closures are excluded from taxable income.[12]

Donation for Haiti Relief. –Provides a monetary donation to a qualified charitable organization for Haiti relief after January 11, 2010, and before March 1, 2010, may

[9] The business asset must be newly purchased tangible personal property that is used more than 50% for business purposes and is eligible to be depreciated under the Code.
[10] Generally, taxpayers take the Section 179 expensing deduction first and claim Section 168(k) depreciation on any remaining basis.
[11] This provision, G.S. 105-134.6(d)(7) and (8), is similar to what the State did in the past when it decoupled from the federal accelerated depreciation provisions.
[12] Part of the WHBA.

be claimed as a charitable deduction on the person's tax return for either 2009 or 2010.[13]

The *Patient Protection and Affordable Care Act*, as amended by the *Health Care and Education Reconciliation Act*, made the following changes to the tax law. This section conforms to these changes:

Medical expense deduction. – Effective January 1, 2013, the threshold for unreimbursed medical expenses will increase from 7.5% to 10% of adjusted gross income. Individuals age 65 and older are temporarily exempt from the increase; it will apply to seniors effective January 1, 2017. Approximately 6% to 8% of North Carolina taxpayers claim the medical expense deduction on their income tax return.

Flexible spending account limits. – Effective January 1, 2011, the definition of "qualified medical expenses" for purposes of Flexible Spending Accounts, Health Spending Accounts, and Health Reimbursement Accounts will be modified to conform to the definition of that term for purposes of the medical expense itemized deduction. This modification means that over-the-counter medicines will not be covered unless they are prescribed by a health care professional. Effective January 1, 2013, the amount a person may contribute to a Flexible Spending Account plan will be limited to $2,500, indexed annually after that year. There is no limit under current law, although some employers may limit the amount that may be set aside.

Executive compensation. – The *Patient Protection and Affordable Care Act* restricts high-level executive pay for insurance providers if the providers do not meet minimum acceptable coverage requirements. Effective January 1, 2011, if at least 25% of premium income does not meet these requirements, the insurer may not claim a deduction for the executive pay to the extent the remuneration exceeds $500,000.

Small Business Tax Relief.[14] *– Section 31.1A provides a refundable income tax credit to a small business equal to 25% of the amount it paid in unemployment insurance tax on wages paid to employees. This section of the act applies only to the 2010 and 2011 taxable years. The estimated loss to the General Fund for fiscal year 2010-11 is $34.1 million.*

Unemployment insurance (UI) tax is a tax on employer payrolls paid by employers and used to provide funds from which unemployment benefits are paid to qualified unemployed workers. The UI tax is not deducted from employee wages. The State UI tax rate[15] is determined annually based on the employer's experience rating.[16] The State UI tax revenues are credited to the State Unemployment Insurance Fund. The average State UI tax rate for all employers through the first half of 2010 was 1.7%.

This section allows a small business a refundable income tax credit equal to 25% of the UI tax paid during the taxable year with respect to wages paid for employment in this State. A small business is a business whose cumulative gross receipts from business activity for the taxable year do not exceed $1 million. Based upon statistics compiled by the Employment Security

[13] P.L. 111-126.

[14] This provision replaces the other provisions proposed by the Senate and House for small business tax relief. The Senate proposed a top rate of 6.9% on small business income (Section 31.2 of SB 897, 3rd Edition) and the House proposed a small business job credit and an extension of the small business health insurance tax credit. (Sections 31.13 and 31.14 of SB 897, 6th Edition).

[15] Based on economic conditions, the rate may be as low as 0.0% or as high as 6.84%.

[16] The experience rating is affected by payroll, tax paid, timeliness of payments, and UI benefits charged against the employer's account.

Commission, there are approximately 125,000 businesses in North Carolina[17] whose gross receipts are less than $1 million. These businesses employ more than 500,000 people. Most of these businesses have 10 or fewer employees. The average annual State UI tax per employee in North Carolina is $265.

The credit provided by this section lowers the cost of maintaining and adding jobs in North Carolina for the next two years. The credit amount is directly related to the amount the taxpayer spends on employment in this State. It does not distinguish between part-time and full-time jobs. Because the credit is based upon the amount of UI tax paid by the business, there is no need for reporting or clawback provisions.

Lower Sales Tax Compliance Burden on Small Retailers. – Section 31.3 decreases the number of retailers required to submit a pre-payment of 65% of the amount of sales tax revenue to be remitted for the following month by changing the threshold for this payment schedule from $10,000 to $15,000, effective October 1, 2010, and from $15,000 to $20,000, effective October 1, 2011.[18] *This change in the law does not change the amount of sales tax revenue remitted to the General Fund, but it does change by one month the timing of the payment for the year of the transition to the higher threshold. It reduces the amount of revenue received in fiscal year 2010-11 by $7 million and the amount received in fiscal year 2011-12 by $12 million.*

Retailers must remit sales tax payments to the State on one of three filing schedules:

> A retailer who is consistently liable for less than $100 a month in sales and use taxes must file a return and pay the taxes due on a quarterly basis.
>
> A retailer who is consistently liable for at least $100 but less than $10,000 a month must file a return and pay the taxes due on a monthly basis.
>
> A retailer who is consistently liable for at least $10,000 a month must make a monthly prepayment of the next month's tax liability. Prior to 2006, retailers in this category had to pay tax twice a month. At the request of several large retailers in the Streamlined Sales Tax Project, North Carolina adopted the once a month payment schedule.[19]

The threshold limit of $10,000 was enacted in 2001 as a means to accelerate the payment of sales and use tax dollars into the General Fund for fiscal year 2001-02.[20] Prior to this change, the threshold amount for making bimonthly payments was $20,000. Since 2001, the State and local tax rate has increased from 6.5% to 7.75%.[21] The lowering of the threshold amount as well as the increase in the tax rate has subjected more retailers to the most extensive sales tax remittance requirements. Some of the small retailers in this category, especially those whose sales are not consistent from month to month, have expressed a cash flow hardship with the pre-payment requirement.

This section restores the sales tax filing thresholds to their pre-2001 level of $20,000 over a two-year period. By increasing the threshold from $10,000 to $15,000, the act relieves 2,133 retailers from the pre-payment requirement. These retailers will continue to file a monthly return

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[17] There are approximately 176,000 firms in North Carolina based on U.S. Census County Business Patterns.

[18] The provision first appeared in the Senate Budget, SB 897, 2nd Edition; it was also in HB 1829, 2nd Edition.

[19] Section 9 of S.L. 2006-33.

[20] The acceleration of sales tax payments in 2001 created a nonrecurring revenue gain of more than $40 million in FY01-02.

[21] In some counties, the combined State and local sales tax rate is 8%.

and pay the sales tax due on a monthly basis. The increase of the threshold from $15,000 to $20,000 will relieve an additional 1,000 plus retailers from the pre-payment requirement.

Relieve Annual Report Compliance Burden on Small Business. – Section 31.4 stipulates that the first annual report of a LLC is due April 15 following its year of organization. The section became effective when the Governor signed it into law on June 30, 2010. The estimated loss to the General Fund for fiscal year 2010-11 is $400,000.

In March 2009, the Secretary of State's Office mailed 270,000 notices to businesses stating they were late in filing their annual reports. Failure to file an annual report is grounds for administrative dissolution for both business corporations and LLCs. The Secretary of State found that many businesses thought their first annual reports were due the year after their formation.[22] The Secretary of State informed the businesses that the first annual report is due on April 15th, regardless of when the business is formed. Under this interpretation, a LLC that filed its articles of organization on April 10th and paid the $125 filing fee would also have to file an annual report five days later along with a $200 annual report filing fee. The Revenue Laws Study Committee considered the issue at the request of many CPAs.

This section does three things to address the areas of concern:[23]

> It conforms the due date for filing annual reports to the due date for filing corporate income tax returns. In 1997, at the recommendation of the General Statutes Commission, the General Assembly set the due date for corporate annual reports at the due date for filing tax returns.[24] The change was designed to make the filing of annual reports easier by establishing a more familiar deadline and allowing the corporation to file the report with its tax return to the Department of Revenue. In 2007, the General Assembly changed the date a corporate tax return is due to be filed from the 15th day of the third month following the close of the corporation's fiscal year to the 15th day of the fourth month.[25] However, a conforming change was not made to the annual report filing statute. The lack of uniformity has caused confusion. Subsection (a) makes the necessary conforming change.
>
> It provides that the first annual report required to be filed by a LLC is due by April 15th of the year *following* the calendar year in which the company files its articles of organization. The section makes this change retroactively by stipulating in the effective date subsection that a LLC whose articles of organization were filed on or after January 1, 2010, but before April 15, 2010, is not required to file an annual report until April 15, 2011. Likewise, it provides that a LLC that was formed before January 1, 2001, and has filed an annual report for each year after the calendar year in which its articles of organization were filed, is considered to have met its annual report filing requirements.

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[22] Prior to the enactment of S.L. 2007-475, annual reports were filed on the anniversary of the business' incorporation. In an attempt to make the filing of the report easier, S.L. 2007-475 provided that a business would file its report with its income tax return to the Department of Revenue.

[23] The Revenue Laws Study Committee recommended this provision as part of SB 1177 and HB 1810. The Senate included it in its version of the budget, SB 897, 3rd Edition, and the House included it in HB 1829, 2nd Edition.

[24] Section 6.1 of S.L. 1997-475.

[25] Section 14 of S.L. 2007-491.

It provides that the annual report must specify the year to which the report applies. The practice of the Secretary of State's Office is to credit an annual report that it receives to the oldest year in which an annual report is due and owing.

Extend Sunset on Expiring Tax Incentive Income Tax Credits and Sales Tax Refunds. – Section 31.5 extends the sunset on four incentive provisions.

This section extends the sunset on the following four incentive provisions:

Tax Credit for Mill Rehabilitation. – Extends the sunset of the credit for rehabilitating vacant historic manufacturing sites from January 1, 2011, to January 1, 2014.[26] The credit was established in 2006 and was last extended in 2008.[27] To be eligible for the credit, a taxpayer must spend at least $3 million to rehabilitate a historic, vacant, former manufacturing facility. The amount of the credit depends upon the development tier in which the site is located and the eligibility of the site for a federal credit.

Tax Credit for Qualified Business Ventures. – Extends the sunset of the credit for investments in qualified business ventures from January 1, 2011, to January 1, 2013.[28] The credit was last extended in 2007. The purpose of the credit is to stimulate early stage investments that help move new technologies from universities and other research laboratories to commercialization. The qualified business investment tax credit is allowed for an individual taxpayer who invests in a qualifying small business. Qualifying small businesses include a business that engages primarily in manufacturing, processing, warehousing, wholesaling, research and development, or a service-related industry, a business that has received within the preceding three years funding from a federal agency under the Small Business Innovation Research Programs, or a business that has been certified by a research university as currently performing under a licensing agreement with the institution for commercializing technology developed at the institution. The credit is equal to 25% of the amount invested and may not exceed $50,000 per individual in a single taxable year. The total amount of tax credits allowed to taxpayers for investments made in a calendar year may not exceed $7.5 million. If the total amount of tax credits claimed exceeds this maximum amount, the credit is allocated proportionately among the taxpayers.

Sales Tax Refund for Passenger Air Carriers. – Extends the sunset of the sales tax refund allowed to an interstate passenger air carrier from January 1, 2011, to January 1, 2013.[29] The sunset was last extended in 2008. In 2005, the General Assembly allowed an annual tax refund to an interstate passenger air carrier for the net amount of sales and use tax paid by it on fuel during a calendar year in excess of $2,500,000. The "net amount of sales and use taxes paid" is the amount of sales tax paid by the interstate passenger air carrier less the refund of that tax allowed to all interstate carriers under

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[26] The Senate budget, SB 897, 3rd Edition, would have extended the sunset to 2012. HB 1829, 2nd Edition, would have extended the sunset to 2014.

[27] Section 28.4 of S.L. 2008-107 clarified the applicability of the credit by specifying that the credit would be allowed so long as an application for an eligibility certification is submitted before the sunset date.

[28] The Senate budget, SB 897, 3rd Edition, would have extended the sunset to 2012. The House budget, S897, 6th Edition, would have extended the sunset to 2013 and expanded the annual cap from $7.5 million to $8 million. The Governor's budget also recommended expanding the cap to $8 million. The act does not expand the cap.

[29] The Senate budget, SB 897, 3rd Edition, would have extended the sunset to 2012. HB 1973, 2nd Edition, would have extended the sunset to 2014.

subsection (a) of G.S. 105-164.14. The refund for which the sunset provision is being extended is in addition to the refund allowed under G.S. 105-164.14(a).

Sales Tax Refund for Motorsports Aviation Fuel. – Extends the sunset of the sales tax refund allowed to a professional motorsports racing team or a motorsports sanctioning body from January 1, 2011, to January 1, 2013.[30] The sunset was last extended in 2008. The General Assembly enacted the annual refund provision in 2005. The amount of the refund is equal to the amount of sales and use tax paid on aviation fuel used to travel to or from a motorsports event in this State, from this State to a motorsports event in another State, or to this State from a motorsports event in another State. For the purposes of the refund, a 'motorsports event' includes a motorsports race, a motorsports sponsor event, and motorsports testing.

Modernize Sales Tax on Accommodations.[31] *– Section 31.6 establishes new sales and use tax and local occupancy tax reporting and remittance obligations on a "facilitator," which is a person who enters into a contract with a provider of transient accommodations to market and collect payment for the rental of accommodations. A facilitator would include an online travel company but not a rental agent. This section becomes effective January 1, 2011, and applies to gross receipts derived from the rental of an accommodation that a consumer occupies or has the right to occupy on or after that date.*[32] *The estimated fiscal impact of this section is a General Fund gain of $1.7 million in fiscal year 2010-11 and $4.9 million in fiscal year 2011-12.*

Gross receipts derived from the rental of transient accommodations are subject to State and local sales tax at the general rate, which is currently 7.75% in most counties. Over 70 counties and over 85 cities also levy an occupancy tax on accommodations, with rates ranging from 1% to 6%. Neither the sales tax nor the occupancy tax applies to a private residence or cottage rented for less than 15 days in a calendar year or to any lodging supplied to the same person for 90 or more continuous days.

Deemed "retailers" under the Sales Tax Article, operators of hotels, motels, tourist homes, tourist camps, and similar type businesses and persons who rent private residences and cottages to transients are required to collect and remit the tax due. This includes rental agents or real estate brokers who rent private residences or cottages to transients on behalf of the owners. However, under the plain language of the statute, online travel companies (OTCs) that list available rooms and collect payment for the rental of those rooms are not retailers required to collect State and local sales and use tax or local occupancy tax on accommodations because they are not "operators" of those accommodations. This interpretation was the holding in the Fourth Circuit case of *Pitt County v. Hotels.com*.[33]

Generally speaking, a person who wishes to make a reservation for an accommodation may contact the accommodation directly, use the services of a commissioned travel agent, or make reservations through an OTC, such as Expedia or Travelocity. OTCs contract with accommodation

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[30] The Senate budget, SB 897, 3rd Edition, would have extended the sunset to 2012. HB 1973, 2nd Edition, would have extended the sunset to 2014.

[31] This provision was a recommendation of the Revenue Laws Study Committee and was included in the Senate budget, SB 897, 3rd Edition.

[32] Based on this language, tax would be owed on the total amount charged by an OTC for a person who made a reservation prior to January 1, 2011, but did not occupy the accommodation until after January 1, 2011.

[33] The *Pitt County* case dealt only with the collection and remittance of local occupancy tax, but since the collection of local occupancy tax is tied to the collection of sales tax, the fact that OTCs are not required to collect State and local sales and use tax is consistent with, though not at issue, in that case.

providers for the right to facilitate or market the reservation of the provider's rooms through the OTC's website. By virtue of their contract with the hotels, the OTCs have no ownership interest or legal right to the rooms, nor do they bear any risk of loss if rooms are not booked through their site. Under the contract, the OTC agrees to pay the provider a discounted room rate and then adds a "facilitation fee" or other similarly-named charge to the discounted room rate and also collects an amount that reflects anticipated taxes plus a nominal service or processing fee. Typically, the facilitation fee is not disclosed to the customer or to the provider, and the amount collected for taxes and fees is not itemized.

With regard to payment, a consumer who books with the provider directly or uses a travel agent typically provides the hotel or agent with a credit card number to guarantee the reservation and then pays the hotel directly at the time of check-out. A consumer who books through an OTC pays up front and prior to occupancy. This business model is known as the "merchant model" or the "prepaid model." Under this model, once the customer occupies the room, the provider bills the OTC for the discounted room rate plus State and local sales tax and occupancy tax, if applicable, based on that rate. Since the provider does not know the final room rate paid by the consumer, it cannot collect sales and occupancy tax based on that amount.

There is little debate that OTCs are required to remit sales and occupancy taxes to a provider of accommodations based on the discounted room rate that they have negotiated. The central issue that has garnered national attention in this industry over the last several years is to what extent OTCs may be required to collect sales tax and occupancy tax based on the marked-up rate that they ultimately charge consumers, which includes their service fees. The Revenue Laws Study Committee studied this issue during the interim prior to the 2010 Regular Session and recommended legislation requiring OTCs to collect and remit sales and occupancy tax on the sales price charged to the consumer. Section 31.6 of this act is a modified version of that initial recommendation.

Section 31.6 does the following:

> ***Definitions.*** – It creates definitions for the terms "accommodation" and "facilitator." An accommodation is defined as a hotel room, a motel room, a residence, a cottage, or a similar lodging facility for occupancy by an individual. A facilitator is defined as a person who is not a rental agent and who contracts with a provider of an accommodation to market the accommodation and to accept payment from the consumer for the accommodation.
>
> ***Gross Receipts Include "Sales Price."*** – It provides that the gross receipts derived from the rental of accommodations include the *sales price* of the rental. "Sales price" is currently defined as the total amount or consideration for which tangible personal property, digital property, or services are sold, leased, or rented, and it includes the retailer's costs as well as charges for any services necessary to complete the sale. This section provides that the sales price of the rental of an accommodation is determined as if the rental were the rental of tangible personal property. In addition, since the definition of sales price includes charges for any services necessary to complete the sale, the sales price of an accommodation rented through an OTC would include the OTC's facilitation fees and any other fee it collects. The rationale for incorporating the term "sales price" is to capture the total cost paid by the consumer for an accommodation regardless of whether it is paid to a hotel directly or to a third party that charges facilitation or other service fees in addition to the room rate.

Notice by Retailer. – It requires a retailer, who, in this case, is the provider of an accommodation, to notify a facilitator with whom it has a contract when an accommodation marketed by the facilitator is completed.

OTC to Report and Remit Within Three Days. – Within three business days of being notified of a completed rental, a facilitator is required to report to the retailer the sales price charged to the consumer and to send the portion of the sales price owed to the retailer and the sales and local occupancy tax due. The retailer is required to remit the sales tax payments received from a facilitator to the Department of Revenue and to remit local occupancy tax payments to the appropriate local tax collecting body, just as the retailer is required to do under current law with respect to the tax owed on the discounted room rate.

Liability. – A facilitator that does not send the tax due on the sales price is liable for the amount of tax the facilitator fails to send, but is not liable for tax sent but not remitted by the retailer. A retailer is not liable for tax due but not received from a facilitator.

Terms of Contract. – The requirements of this section are considered to be terms of the contract between a retailer and a facilitator.

Sourcing. – It codifies the current practice with regard to sourcing transactions for the rental of transient accommodations by stating that they are sourced to the location of the accommodation.

Local Occupancy Tax. – It makes conforming changes to the statute that sets out the uniform provisions for occupancy taxes. In doing so, it imposes the same responsibility and liability on a facilitator with regard to occupancy tax as the facilitator would have for State sales tax on accommodations. It also makes clear that the room occupancy tax applies to the same gross receipts and is calculated in the same manner as the State sales tax on accommodations.

Modernize Admissions Tax and Restore Amenities Exclusion.[34] *– Section 31.7 extends the admissions tax to the Internet resale of tickets by a person engaged in the business of reselling. This provision is effective January 1, 2011, and applies to admission tickets sold on or after that date. This section also restores the Department of Revenue's pre-2009 interpretation of the admissions tax statute to exclude from tax charges for amenities that are bundled with a ticket purchase. This provision is effective for charges for admission received on or after August 1, 2010. The estimated fiscal impact of this section is a recurring annual loss of $700,000.*

Modernize Admissions Tax. – North Carolina imposes a 3% privilege tax on the gross receipts of a person who offers or manages any of the following taxable amusements:

A dance or athletic contest for which admission fee in excess of 50¢ is charged.

Amusement or entertainment for which an admission is charged.

A performance, show, or exhibition, such as a circus or dog show.

G.S. 14-344 limits the total amount a seller or reseller of an admission ticket may charge to "…the combined face value of the ticket, tax and the authorized service fee." The service fee may not exceed $3.00 unless the promoter of the event and the ticket sales agency agree in

[34] This provision was a recommendation of the Revenue Laws Study Committee and was included in the Senate budget, SB 897, 3rd Edition.

writing to a different amount and that amount is made known to the public in writing. A violation of this section is punishable as a Class 2 misdemeanor.

In 2008, as part of S.L. 2008-158 (Senate Bill 1407), the General Assembly enacted G.S. 14-344.1. This statute authorizes a person to resell an admission ticket on the Internet with no cap on price unless the resale is prohibited by the venue. A person who resells an admission ticket under this statute is required to provide a ticket guarantee that must be conspicuously displayed on the person's Website and to direct a prospective purchaser to the ticket guarantee before completion of the resale transaction. The guarantee must provide that a purchaser will be given a full refund if any of the following occurs:

> The event is cancelled.
>
> The purchaser is denied admission other than due to an act or omission by the purchaser.
>
> The ticket is not delivered as promised resulting in purchaser's inability to attend event.

Under current law, ticket resales are not subject to the admissions tax because the secondary seller is not "giving, offering, managing, or exhibiting" the amusement. The reseller does not fall within the scope of the statute. As a compromise agreement in 2008, the General Assembly required Internet ticket resellers to report their gross receipts for North Carolina events to the Department of Revenue on a monthly basis. Since August 2008, there have been 65 reports, reflecting 17 reporting entities.

Section 31.7 modernizes the tax on admissions as follows:

> It extends the 3% admissions tax to the gross receipts of a person who is engaged in the business of reselling tickets under G.S. 14-344.1. The gross receipts exclude the price printed on the face of the ticket. Thus, the tax is imposed on the difference between the price sold and the face value of the ticket. If the price is not printed on the ticket, the tax applies to the difference between the amount the reseller paid for the ticket and the amount the reseller charges for the ticket.[35] This provision modernizes the admissions tax by recognizing the current business model for the sale and resale of tickets, which did not exist at the time the admissions tax was originally enacted in the 1930s. It also equalizes the admissions tax by treating the markup in a resale transaction the same as the face value price in the first sale.
>
> It makes the collection and remittance of the admissions tax on ticket resales a condition of reselling tickets on the Internet. Under current law, there are only two conditions. First, a person may resell tickets on the Internet if the venue has not prohibited the resale by filing a notice with the Secretary of State. Second, the ticket reseller must also provide the purchaser with a guarantee assuring the legitimacy of the ticket and offering a refund in the event the purchaser is denied access to the event through no fault of the purchaser.
>
> It repeals the reporting requirement. The reporting requirement was added to S.L. 2008-158 when the tax provision was removed. That act originally included a sunset, which required the General Assembly to revisit the legislation. At the time, the rationale for the reporting requirement was to provide the General Assembly with data for when it reconsidered the legislation. Now, by taxing these transactions, there is no need for a reporting requirement.

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[35] This same tax provision passed the Senate when S.L. 2008-158 was being considered during the 2008 Regular Session, but it was removed when the bill was considered in the House Finance Committee.

It provides for the repeal of G.S. 14-344.1 if a court finds that the privilege tax violates the Internet Tax Freedom Act (ITFA) or is otherwise found to be invalid. ITFA temporarily prohibits states from imposing multiple or discriminatory taxes on electronic commerce. A discriminatory tax is one that is not generally imposed and legally collectible on transactions involving similar property, goods, services or information accomplished through other means. Arguments have been raised as to whether this legislation might violate ITFA because it taxes only those ticket resales that occur on the Internet. However, face-to-face ticket resales for greater than face value are generally illegal in North Carolina. As such, a counter argument may be made that Internet ticket resales are, in fact, given preferential treatment to the extent they are authorized, with no cap, whereas face-to-face ticket resales are essentially prohibited. A similar transaction cannot be conducted by a means other than the Internet. However, since the issue has been raised, the section provides that if a court finds that the privilege tax violates ITFA, then the authority to resell tickets on the Internet is repealed.

It prohibits cities or counties from imposing a privilege license tax on Internet ticket resellers.

This part of the section becomes effective January 1, 2011, and applies to admission tickets sold on or after that date.

Restore Amenities Exclusion. – Entertainment venues frequently offer their patrons certain amenities in conjunction with the sale of admission tickets to performances of live entertainment. Those amenities may include parking privileges, preferential or more luxurious seating, access to special concession stands, access to luxury viewing suites, and access to concierge staff. In some cases, the venue will separately state the "seat price" on the face of a ticket with charges over and above that price reflecting the cost of the amenities. In other cases, a purchaser may buy a package or contract for the lease of a suite where the price includes a seat for an event as well as amenities, but the charges are not separately stated.

The current admissions tax statute does not specifically address how these amenities are to be taxed. In 1994, a taxpayer requested a written opinion from the Department of Revenue as to whether the admissions tax applied to amenities, and the Department responded that amenities were excludable from the tax. This interpretation was in place for over 15 years, and during that time, the statute did not change in any substantive way. However, on January 30, 2009, the Department issued a directive, effective the following day, stating that amenities are subject to the admissions tax. Specifically, the directive reads:

> "Gross receipts are taxes computed on the admission price of the amusement. An admission price is the price paid to enter an event. Effective for tickets for admission sold on or after February 1, 2009, the gross receipts tax is due on the price paid by the customer for admission into an event regardless of whether that price just covers the seat price or also includes amenities."

The Revenue Laws Study Committee considered this issue during the 2009-2010 interim given that it is a matter of tax policy on which the statute is silent and because the Department reversed its longstanding interpretation of the statute despite the fact that the statute has remained the same. The Committee concluded that the decision of whether amenities should be subject to the admissions tax is one for the Legislature and should not be determined by an interpretive ruling.

Subsection (a) of this section restores the Department's pre-2009 interpretation of the admissions tax statute by excluding amenities from the tax. If the charges for the amenities are not

separately stated on the face of the ticket, then the charge for admission would be equal to the charge for a ticket to the same event that does not include amenities and that is for a seat located directly in front of or closest to a seat that includes amenities. This provision became effective for charges for admission received on or after August 1, 2010.

Give Taxpayers Notice of Revised Tax Interpretations.[36] *– Section 31.7A requires the Department of Revenue to provide ample notice to taxpayers when it issues an interpretation that revises a prior interpretation by expanding the scope of a tax or otherwise increasing the amount of tax due. This provision became effective when the Governor signed the act into law on June 30, 2010.*

G.S. 105-264 provides that it is the duty of the Secretary of Revenue to interpret all laws administered by the Department. When the Secretary interprets a law by adopting a rule or publishing a bulletin or directive, the interpretation is a protection to the officers and taxpayers affected by the interpretation, and taxpayers are entitled to rely upon the interpretation. The Secretary is permitted to change an interpretation, and that change may apply on and after the effective date of the change, but there is no statutory requirement that the Department provide a certain amount of notice to taxpayers prior to applying a revised interpretation.

In the course of considering whether amenities associated with ticket sales should be subject to tax, the Revenue Laws Study Committee learned that the Department reversed its position on the taxability of amenities with one-day's notice to taxpayers. The Committee was persuaded that G.S. 105-264 should be amended to require some level of notice prior to the Department changing the interpretation of a tax law that expands the scope of a tax. Therefore, this provision requires the Department to provide notice to taxpayers if it revises a prior interpretation by expanding the scope of a tax or otherwise increasing the amount of tax due. Under this section, a revised interpretation would not become effective until the sooner of the following:

> For a tax that is payable on a monthly or quarterly basis, the first day of a month that is at least 90 days after the date the revised interpretation is issued.
>
> For a tax that is payable on an annual basis, the first day of a tax year that begins after the date the revised interpretation is issued.

Improve Tax and Debt Collection Process.[37] *Section 31.8 improves the tax and debt collection process of the Department of Revenue by:*

> *Expanding the use of the Setoff Debt Collection Act to allow the following: debts owed by a business to be set off against a tax refund due the business, a setoff against any type of tax refund, and a community college to submit for setoff debts owed the college.*
>
> *Authorizing the use of electronic process for sending notice of garnishment.*
>
> *Providing for a data match between the Department of Revenue and financial institutions holding accounts of delinquent taxpayers.*
>
> *Expanding the Statewide Accounts Receivable Program to allow for collection of the following accounts receivable by setoff against payments the State owes to individuals and*

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[36] This provision was a recommendation of the Revenue Laws Study Committee and was included in the Senate budget, SB 897, 3rd Edition.

[37] The Revenue Laws Study Committee recommended this provision in SB 1188 and HB 1881. The provision also appeared in HB 1829 2nd Edition.

businesses: accounts receivable that are submitted to the Department of Revenue under the Setoff Debt Collection Act and overdue tax debts.

These improvements to the tax and debt collection process were initially recommended to the Revenue Laws Study Committee by the Department of Revenue, developed in collaboration with the Office of State Controller and the North Carolina Bankers Association. [38] *Unless otherwise stated, section 31.8 became effective when the Governor signed the act into law on June 30, 2010.*

The improvements are expected to increase revenue by $3 million for each fiscal year beginning in fiscal year 2010-2011.

Expansion of Setoff Debt Collection Act. – The Setoff Debt Collection Act, enacted in 1997, authorizes the Department of Revenue to set off an individual's income tax refund against a debt the individual owes a State agency or local agency.[39] Under the Act, a claimant agency sends the Department notice of the debt and the Department immediately sets off the debt against the tax refund and notifies the taxpayer and the claimant agency.

Subsections (d) through (g) of this section expand the Setoff Debt Collection Act to allow community colleges to collect debts owed to them through setoff of tax refunds and to allow debts that a business owes a claimant agency to be set off against the entity's tax refund. Previously, the Act only allowed debts owed to claimant agencies by individuals to be set off against the individual's income tax refund. The act also expands the Setoff Debt Collection Act to apply to any type of tax refund, not just income tax refunds.

Notice of Garnishment by Electronic Process. – The Department of Revenue is authorized by statute to attach and garnish intangible property in payment of taxes owed to the Department. The kinds of property that are subject to attachment and garnishment are wages and salaries, rents, bank deposits, the proceeds of property subject to levy, and property in the Escheat Fund. When the property sought to be attached is the taxpayer's checking account, the garnishee is the bank. When the property is wages, the taxpayer's employer is the garnishee. No more than 10% of a taxpayer's wages or salary per month is subject to attachment and garnishment. Current law requires that the notice of garnishment must be delivered in person or by mail.

Subsection (i) of this section authorizes electronic notice, if the garnishee agrees to this method and the Department and garnishee have an agreement that establishes the protocol for electronic notice. The act also streamlines the process if the garnishee is a financial institution by reducing the time period for filing a response to the notice of garnishment from 30 days to 20 days and by releasing the notice of garnishment when the institution complies with the notice. All other garnishees will continue to receive a notice of release. Streamlining is consistent with the current garnishment practice with banks wherein the Department faxes notice of garnishment to a bank and the bank then sends money in the account to the Department within 10 to 15 days.

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[38] See a synopsis of this legislation at the following School of Government website: http://sogweb.sog.unc.edu/blogs/localgovt/?m=201007

[39] State agency includes a unit of the executive, legislative, or judicial branch of State government and a local agency to the extent it administers a program supervised by the Department of Health and Human Services. A local agency includes a county, municipality, water and sewer authority, regional joint agency created by interlocal agreement, public health authority, metropolitan sewerage district, or sanitary district.

A "financial institution" is defined as a banking corporation, trust company, savings and loan association, credit union, or other entity principally engaged in the business of lending money or receiving or soliciting money on deposit.[40]

Data Match between Financial Institutions and the Department of Revenue. – Subsection (h) of this section becomes effective January 1, 2011, and will further streamline the attachment and garnishment process by providing for a data match between financial institutions and the Department of Revenue. The Department will be authorized to submit information to a financial institution on a quarterly basis, or with the agreement of the financial institution, more frequently. The information will identify any delinquent taxpayer to a financial institution and require the financial institution to notify the Department of the amount the institution may hold that belongs to the taxpayer. The Department will reimburse the financial institution for the cost of providing the information. The cost may not exceed the amount that the Department of Health and Human Services currently pays to financial institutions for conducting a data match in order to attach and garnish the account of an absent noncustodial parent.[41]

The federal government has issued a proposed rule to implement statutory restrictions on the garnishment of federal benefit payments.[42] These payments are protected under federal law from garnishment and include Social Security benefits, Supplemental Security Income benefits, and VA benefits. The rule sets forth uniform procedures for financial institutions to follow in order to minimize the hardships encountered by federal benefit payment recipients whose accounts are frozen pursuant to a garnishment order. The rule also assists financial institutions to determine whether exempt funds were directly deposited to the account.

Expansion of Statewide Accounts Receivable. – The Statewide Accounts Receivable Program, enacted in 1993, requires the State Controller to monitor accounts receivable owed to State agencies, to adopt procedures for the management and collection of accounts receivable, and to establish procedures for writing off accounts receivable.[43] The Program also provides for written-off accounts receivable to be set off against payments the State owes to debtors. A written-off accounts receivable is one that has been removed from a State agency's accounts receivable records.

Subsections (a) through (c) of this section expand the Statewide Accounts Receivable Program as follows:

> Expand the definition of "accounts receivable" to include taxes.
>
> Allow debts that have been submitted to the Department of Revenue under the Setoff Debt Collection Act to be set off against payments the State owes to these debtors. The following is an example of how this improvement will work. The Department of Revenue will give the State Controller a list of debtors under the Setoff Debt Collection Act. The State Controller will then check to see if any of these debtors are vendors that are owed money by the State for services or goods received by the State. The State Controller

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[40] G.S. 53B-2.

[41] The DHHS and financial institutions have developed a data match system that requires a financial institution to provide DHHS the following information on a quarterly basis in order to secure child support: name, SSN, address, telephone number, account numbers, and other identifying data for any person who maintains an account at the financial institution.

[42] Garnishment of Accounts Containing Federal Benefit Payments 75 Fed. Reg. 20299 (April 19. 2010).

[43] An account receivable is an asset of the State reflecting a debt owed to the State. The term includes claims, damages, fees, fines, forfeitures, loans, overpayments, and tuition as well as penalties, interest and other costs authorized by law. The term does not include court costs or fees.

will then deduct the amount of the debt from the amount owed by the State. The State Controller will send this amount to the claimant agency owed the debt.

Reduce Franchise Tax Burden on Construction Companies.[44] *– Section 31.9 applies the provision enacted last session excluding from a corporation's franchise tax base all billings in excess of costs retroactively to taxable years beginning on or after January 1, 2007.*

The State imposes a franchise tax on C-corporations and S-corporations. The tax rate is $1.50 per $1,000[45] and is applied to a company's capital stock, surplus, and undivided profits.[46] The term "surplus" for franchise tax purposes has a broader and more inclusive meaning than the generally accepted accounting definition. G.S. 105-122(b) provides that surplus and undivided profits include all liabilities, reserves, and deferred credits unless those items are specifically exempt. One of the exemptions from surplus and undivided profits is "definite and accrued legal liabilities." The Department of Revenue defines a definite and accrued legal liability as one that meets both of the following conditions:

> The liability is definite in amount, meaning it is exactly determined and not merely accurately estimated.
>
> The liability will be incurred before the end of the taxable year.

Generally accepted accounting principles require that revenue be recorded in the period it is earned regardless of when it is billed or when cash is received. In long-term construction contracts, there is often a mismatch between actual billed revenue and earned revenue. Sometimes elements of a contract are billed in advance and sometimes they are delayed. The accounting solution to this problem is the percentage of completion method of revenue recognition. Under this method of accounting, where the costs can be reasonably estimated, revenue is recognized as production takes place. This method of accounting may result in "billings in excess of costs" or "cost in excess of billings." Billings in excess of costs is a balance sheet liability because it represents unearned income. Cost in excess of billings is a balance sheet asset. For purposes of the State's franchise tax, the balance sheet liability of "billings in excess of costs" is not considered a definite and accrued legal liability because it is based on estimates; therefore, it is included in a corporation's capital base.

The construction industry sought to change this interpretation because it resulted in contractors having to pay taxes on liabilities and for revenue they had not actually received. S.L. 2009-422 adopted the industry's position by providing billings in excess of costs that are determinable using the percentage of completion principles are exempted from surplus and divided profits, and therefore, excluded from the franchise tax base. The act became effective for taxable years beginning on or after January 1, 2010.

The Department of Revenue audited some companies and assessed additional tax on them for taxable years prior to 2010 for excluding billings in excess of costs from their capital base. This section applies the 2009 law change retroactively to 2007. It also allows a taxpayer that paid franchise tax in taxable years 2007, 2008, or 2009 and that included billings in excess of costs in its capital base to apply to the Department for a refund of any excess tax paid to the extent the refund is the result of the retroactive application of the billings in excess law

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[44] This provision was included in the Senate budget, SB 897, 3rd Edition.

[45] The minimum tax is $35.

[46] A corporation's capital base may not be less than 55% of the appraised value of tangible property in NC, or less than its actual investment in tangible property in the State.

change. A request for a refund must be made on or before January 1, 2011. A request for a refund received after that date is barred.

Fair Tax Penalties. – Section 31.10 provides that a penalty for understatement of tax due does not apply to a taxpayer who complies with the Secretary of Revenue's request and files a consolidated or combined return and that a failure to pay penalty does not apply to a taxpayer who has requested a hearing on the tax liability used as the basis for the penalty. It requires a corporation to file a consolidated or combined return when the corporation's facts and circumstances meet those described in a permanent rule adopted by the Department of Revenue or when they meet those described in a letter of written advice provided by the Secretary to the corporation at the request of the corporation.[47] This section became effective when the Governor signed it into law on June 30, 2010. This section does not impact the General Fund.

North Carolina is a single entity filing state, meaning that a multistate corporation must determine its State net income as if it filed a separate return for federal income tax purposes. G.S. 105-130.14 prohibits a corporation from filing a consolidated or combined return in North Carolina unless specifically directed to do so by the Secretary of Revenue. Under G.S. 105-130.6, the Secretary can require a corporation to file a combined return with other parent, subsidiary, or affiliated corporations when the Department believes the corporation's net income attributable to this State is not accurately reflected on its separate entity filing return.[48] G.S. 105-130.6 states that a corporation has 60 days to file a combined return after being directed to do so by the Secretary before the corporation is subject to penalties under G.S. 105-236. The penalties under G.S. 105-236 include a failure to file penalty of 5% to 25%, a failure to pay penalty of 10%, a negligence penalty of 10%, and a large understatement penalty of 25%. It appears the Department's penalty practice when it requires combined returns is as follows:

Action	**Failure to File Penalty** 105-236(a)(3)	**Failure to Pay Penalty** 105-236(a)(4)	**Large Deficiency/ Negligence Penalty** 105-236(a)(5)
Return filed within time requested and payment made	No	No	Yes
Return filed within time requested but no payment with return because hearing requested	No	Yes	Yes
Return not filed within time requested but hearing requested	Yes	Yes	Yes

This section clarifies the circumstances under which a corporation may be required to file a consolidated or combined return and the applicability of the penalties to those returns. It also

[47] This provision was included in the Senate budget, SB 897, 3rd Edition, and in SB 1172.

[48] The Department of Revenue has collected millions of dollars in taxes from forced combinations. The Department generated $424 million through Resolution Initiative in 2009. The Current Operations and Capital Improvements Appropriations Act of 2010 includes $110 million in its adjustments to availability attributable to 'Department of Revenue Settlement Initiative'.

provides that a failure to pay penalty does not apply to a taxpayer who has requested a hearing on the tax liability used as the basis for the penalty.

Subsection (d) of this section allows the Secretary to adopt rules that describe facts and circumstances under which the Secretary would require a corporation to file a consolidated or combined return. This provision does not limit the Secretary's authority under G.S. 105-130.6 to require a corporation to file a consolidated or combined return when the Secretary finds as a fact that a single entity report does not disclose the true earnings of a corporation on its business carried on in this State. Subsection (f) of this section provides expedited notice and hearing procedures for the Department to follow when adopting these rules.[49] The expedited notice and hearing procedures mirror those required of the State Ethics Commission.

Subsection (e) of this section creates two new exceptions to the general rule requiring a corporation to file a single entity return. Under prior law, a corporation could not file a consolidated or combined return unless the Secretary required the corporation to do so in writing. This subsection requires a corporation to file a consolidated or combined return in the following circumstances:

> The corporation's facts and circumstances meet the facts and circumstances described in a permanent rule adopted by the Department.
>
> Pursuant to a written request from the corporation, the Secretary has provided written advice to the corporation stating that the Secretary will require a consolidated or combined return under the facts and circumstances set out in the request.

Subsection (b) of this section affects taxpayers that file a combined return at the written direction of the Secretary, under a permanent rule adopted by the Department, or pursuant to written advice the taxpayer receives from the Secretary at the request of the taxpayer. It provides that the difference between the taxes due on a combined return filed under one of these circumstances, as compared to the taxes due on a single entity return, is not considered a deficiency and is not subject to the negligence or understatement penalties under G.S. 105-236(a)(5). Previously, these penalties were being assessed even though the taxpayer could not lawfully file the combined return without receiving the request from the Secretary.

Subsection (a) of this section makes it clear that a taxpayer who disputes the amount of tax owed and requests a hearing on the issue is not subject to a penalty for failure to pay the disputed tax before the hearing is held. As set out in this subsection, a taxpayer who requests a hearing has 45 days after the conclusion of the administrative process to pay any amount that is determined to be due without incurring a failure to pay penalty. If the amount is not paid within the 45-day period, the penalty applies. This change is consistent with the tax appeal provisions contained in G.S. 105-241.9 through G.S. 105-241.16, which provide that a taxpayer does not need to pay the tax due when an assessment is made against the taxpayer in order to have a hearing on the merits of the taxpayer's defense to the assessment before an independent hearing officer.

Subsections (a) and (b) of this section apply to penalties that are assessed and unpaid as of the effective date, except penalties and taxes that are the subject of pending litigation in a General Court of Justice as of the effective date, and to penalties and taxes assessed on or after that date.

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[49] As a general rule, the Department of Revenue is exempt from notice and hearing requirements under Chapter 150B of the North Carolina General Statutes.

Subsection (c) of this section is a technical change that makes it clear that the filing of a combined return at the request of the Secretary does not trigger the automatic collection of the tax. G.S. 105-241.22(1) is intended to apply when a taxpayer files an original or amended individual income tax return that shows an amount due but does not include payment.

Subsection (g) specifically states that the changes made by this section should not be construed to affect the interpretation of any statute that is the subject of litigation pending as of the effective date of this act in the General Court of Justice or to affect any other aspect of such pending litigation.

No Add-Back for Film Credit/Apportionment.

Session Law	*Bill #*	*Sponsor*
S.L. 2010-89	**HB 713**	**Rep. Allen, Gibson**

AN ACT TO PROVIDE THAT THE ADDITION TO FEDERAL TAXABLE INCOME OF AMOUNTS ALLOWED AS A CREDIT AGAINST NORTH CAROLINA INCOME DOES NOT APPLY TO THE FILM CREDIT AND TO INCREASE THE PERIOD OF TIME FOR WHICH THE SECRETARY OF REVENUE MAY ALLOW A CORPORATION TO USE AN ALTERNATIVE APPORTIONMENT FORMULA.

OVERVIEW: This act does two things:

It reduces the corporate tax liability of a taxpayer who claims the film credit by providing that the taxpayer does not have to make an addition to federal taxable income when computing North Carolina taxable income for the amount of the credit taken against the tax.

It increases the period of time for which the Secretary may allow a corporation to use an alternative apportionment formula from three taxable years to fifteen taxable years.

FISCAL IMPACT: The film credit change will result in an annual loss to the General Fund of approximately $800,000, beginning in fiscal year 2011-12. The fiscal impact of increasing the period of time for which a taxpayer may use an alternative apportionment formula is unknown. *(For a more complete fiscal analysis, see NC 2010 Legislative Session Budget and Fiscal Policy Highlights. Available online:* http://www.ncleg.net/fiscalresearch/highlights/highlights_pdfs/2010_Session_Highlights.pdf)

EFFECTIVE DATE: The change in the corporate income tax law applicable to taxpayers claiming the film credit becomes effective for taxable years beginning on or after January 1, 2011. The remainder of the act became effective when the Governor signed it into law on July 11, 2010.

ANALYSIS: This act includes two changes to the corporate income tax laws to make them more favorable to film production companies and to certain companies seeking to use an alternative apportionment formula.

Film Production Credit. – In 2009, the General Assembly increased the income tax credit for a production company from 15% to 25% of the company's qualifying expenditures,[50] and this session the General Assembly increased the cap of the film credit from $7.5 million to $20 million.[51] Section 1 of this act provides another enhancement to the corporate income tax film

[50] S.L. 2009-529.
[51] S.L. 2010-147.

credit by not requiring a taxpayer to add back to its federal taxable income for State income tax purposes the amount of any film credit the taxpayer received during the taxable year.[52] The General Assembly made this change at the request of the film industry, who argued the taxation of the credit amount reduced the value of the credit taken. This exception to the general law will reduce the corporate income tax liability of a taxpayer claiming a film credit in the subsequent taxable year and will result in annual loss to the General Fund of approximately $800,000. The change becomes effective for taxable years beginning on or after January 1, 2011.

Alternative Apportionment Formula. – Section 2 of the act allows the Secretary of Revenue to apply a written decision granting a corporation's request for an alternative apportionment formula method for fifteen years instead of three years, effective for requests filed on or after July 11, 2010. Subsections (a) and (b) apply to the corporate income tax; subsection (c) makes a similar change to the corporate franchise tax.

A corporation must use the statutory double-weighted sales factor apportionment formula unless the corporation requests an alternative apportionment formula and the Secretary of Revenue grants the request. A return filed that uses an alternative apportionment formula that is not permitted by the Secretary is not a lawful return. A corporation that believes the double-weighted sales factor apportionment formula subjects a greater portion of its income to tax than is attributable to its business in this State may make a written request to the Secretary of Revenue for permission to use an alternative method. The request must set out the reasons for the corporation's belief and propose an alternative method. A corporation has the burden of establishing by clear, cogent, and convincing proof that the proposed alternative method is a better method of determining the amount of the corporation's income attributable to the corporation's business in North Carolina.

The Secretary must issue a written decision on a corporation's request. If the decision grants the request, it must describe the alternative method the corporation is authorized to use and state the tax years to which the alternative method applies. The Secretary's decision is final and is not subject to administrative or judicial review. A decision may apply to no more than three tax years. A corporation may renew its request to use an alternative apportionment method.

This section allows a corporation that signs a letter of commitment by September 15, 2010, certifying it plans to invest at least $500 million in private funds to construct a facility in a development tier one area within five years after the time construction begins[53] to request the Secretary of Revenue to grant the corporation permission to use an alternative apportionment method. The Secretary of Commerce would have to certify that the corporation meets the investment criteria. The corporation would follow the same procedures as prescribed by current law to make the request and would have to meet the same burden of proof as required by current law. The only difference would be that if the Secretary of Revenue grants the request, the decision may apply for as many as fifteen tax years, instead of only three tax years.

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[52] The film credit may also be taken against the personal income tax when the taxpayer is a pass-through entity. However, the personal income tax does not require a similar add-back to federal taxable income; therefore, a corresponding change in the personal income tax statute was not needed.

[53] Microsoft requested this change because it was considering investing at least $500 million in a datacenter in Cleveland County. However, on August 27, 2010, it was announced that Microsoft decided to locate the datacenter in Virginia.

The apportionment formula is the conventional method used by states to source income of a corporation that does business in more than one state.[54] Generally speaking, a taxpayer multiplies its taxable income by its apportionment percentage to determine the amount of its income sourced to a state. The state's corporate income tax rate is applied to the corporation's income apportionable to that state. Most states use an apportionment formula based on or substantially similar to the Uniform Division of Income for Tax Purposes Act (UDITPA). The UDITPA formula is a composite of three factors: a property factor, a payroll factor, and a sales factor. The property factor represents the ratio of the taxpayer's real and tangible personal property in the taxing state to its real and tangible personal property everywhere. Likewise, the payroll factor and the sales factor represent a ratio of the taxpayer's payroll and sales in the taxing state to its payroll and sales everywhere. Under UDITPA, the sum of the three factors is divided by three, resulting in a taxpayer's apportionment percentage.

North Carolina shifted to a double weighted sales factor apportionment formula in 1988 at the request of RJR Nabisco. A double weighted sales factor tends to favor home state industries that have a concentration of their total facilities in a state but sell their products all over the country. Under North Carolina's current apportionment formula, the payroll and property factors are each weighted 25% and the sales factor is weighted at 50%; the sum of the four factors is divided by four.

Last session[55] the General Assembly changed the corporate income tax apportionment formula used by a capital intensive multistate corporation[56] meeting specific investment criterion from a three-factor formula based upon property, payroll, and double weighted sales to a single sales factor formula. Under the single sales factor formula, the total allocation of a corporation's nationwide profits to North Carolina is solely based on where the corporation's sales occur. 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. Unlike the provision in this act, a corporation meeting the statutory conditions to be considered capital intensive[57] may use the single sales factor apportionment method; it does not have to make a written request of the Secretary, and the Secretary has no decision-making responsibility in the matter.

Keeping NC Competitive Act.

Session Law	*Bill #*	*Sponsor*
S.L. 2010-91	**SB 1171**	**Senator Clodfelter**

AN ACT TO MODIFY ELIGIBILITY FOR ECONOMIC INCENTIVE SALES AND USE TAX EXEMPTIONS AND REFUNDS; TO MODIFY ELIGIBILITY FOR THE ONE PERCENT PRIVILEGE TAX ON DATACENTER MACHINERY AND EQUIPMENT; AND TO MODIFY THE

[54] The U.S. Supreme Court cases have upheld the right of states to tax the income of multistate corporations so long as the income is fairly sourced to the taxing state.

[55] S.L. 2009-54. The act provided that if no corporation met the capital intensive requirements by January 1, 2019, the single sales factor provision would be repealed.

[56] The General Assembly made the change at the request of Apple, who built a major datacenter in Maiden, N.C.

[57] The corporation must meet certain investment, employment, wage, employee benefit, and location conditions. G.S. 105-130.4(s1).

CIRCUMSTANCES UNDER WHICH THE DEPARTMENT OF COMMERCE MAY EXTEND THE BASE PERIOD FOR A JDIG GRANT.

OVERVIEW: This act provides the following tax incentives requested by the Department of Commerce to aid in its recruitment initiatives:

- An expansion of the sales tax exemption available to an Internet datacenter for the electricity and business property used at its facility to include a datacenter engaged in software publishing.
- An annual refund of the sales and use tax paid on building materials, supplies, fixtures, and equipment to construct a paper-from-pulp manufacturing facility and a turbine manufacturing facility.
- A modification of the requirements for a datacenter to qualify for the 1% excise tax on the machinery and equipment it purchases. The modification allows a datacenter to meet its investment threshold through the construction of two facilities, rather than one facility. The act also extends the sunset on this provision from July 1, 2013, to July 1, 2015.
- The creation of an option for contractors and subcontractors that allows them to elect to pay the lower 1% excise tax rather than the sales and use tax on its purchases of machinery and equipment in connection with a datacenter.
- A modification of the circumstances under which the Department of Commerce may extend a business' base period and the length of that extension under the Job Development Investment Grant Program.

FISCAL IMPACT: Fiscal Research estimates a fiscal impact of $8.9 million in fiscal year 2010-11 and $13.7 million in fiscal year 2011-12. *(For a more complete fiscal analysis, see NC 2010 Legislative Session Budget and Fiscal Policy Highlights. Available online:*

http://www.ncleg.net/fiscalresearch/highlights/highlights_pdfs/2010_Session_Highlights.pdf)

EFFECTIVE DATE: See ANALYSIS.

ANALYSIS:

Sales Tax Exemptions. – In 2006, the General Assembly granted a sales tax exemption to an Internet datacenter for the electricity and business property used at its facility.[58] For purposes of the exemption, an "eligible Internet datacenter" is defined as a facility that meets the following requirements:

- Its primary business is as a Web search portal included in Industry 51811 of NAICS.[59]
- It is comprised of a structure or series of structures located on contiguous parcels of land owned by the same operator.

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[58] G.S. 105-164.13(55); S.L. 2006-66. At the time the legislation was being considered, Google was considering Lenoir as a possible site for one of its server farms, and this tax incentive was part of the recruitment package being offered.

[59] The North American Industry Classification System, or "NAICS," is the standard used by Federal statistical agencies in classifying business establishments for the purpose of collecting, analyzing, and publishing statistical data related to the U.S. business economy. It was developed under the auspices of the Office of Management and Budget (OMB) and adopted in 1997 to replace the Standard Industrial Classification (SIC) system.

- It is located in a development tier one or two county.
- The owner commits at least $250 million of private funds in the facility over a five-year period.

Under this definition, the exemption applied to a facility engaged in Web search portals.[60] Section 1 of this act broadens the definition of an eligible Internet datacenter to include not only a facility that operates Web search portals but also facilities engaged in software publishing.[61] The remaining components of the definition did not change. This change became effective July 1, 2010, and applies to sales made on or after that date.

The General Assembly began offering sales tax exemptions to encourage companies to locate and expand in North Carolina[62] in 1998 when it granted a sales tax exemption to a major recycling facility[63] for the lubricants and other additives used at its facility for its machinery and equipment, for the electricity used at its facility, and for the materials and supplies consumed in the manufacturing processes at its facility.[64]

To be exempt, the business property must be located at the facility, it must be capitalized for tax purposes under the Code, and it must be used for one of the following purposes:

- For the provision of a service provided as part of its primary business.
- For the generation, transformation, transmission, distribution, or management of electricity.
- For the provision of related computer engineering or computer science research.

The owner of an Internet datacenter must forfeit the sales tax exemptions it has been allowed if it fails to meet the investment threshold, fails to locate and use the property at the datacenter, or fails to use the electricity at the datacenter. A taxpayer that forfeits an exemption is liable for all past taxes avoided as a result of the exemption, computed from the date the taxes would have been due if the exemption had not been allowed, plus interest. The past taxes and interest are due 30 days after the date the exemption is forfeited.

Section 2 of the act updates the NAICS reference used in the sales and use tax statutes to the most recent edition of NAICS.[65] The Office of Management and Budget[66] updates NAICS every five years. As part of this update, the 2002 NAICS classification for "Internet Service Providers and Web Search Portals," Industry 51811, was changed in the 2007 edition of NAICS to "Internet Publishing and Broadcasting and Web Search Portals," Industry 519130. Section 1 made this conforming change. Section 3 also makes a conforming change in language that was based upon the wording used in the 2002 edition of NAICS.

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[60] Google and Facebook are examples of an Internet datacenter that operate Web search portals.
[61] Microsoft is an example of an Internet datacenter engaged in software publishing. North Carolina was one of three sites Microsoft considered for the location of its datacenter to serve as the East Coast hub for its online services. Microsoft selected a site near Boydton, Virginia in August 2010.
[62] There are at least seven sales tax exemptions targeted to specific industries: G.S. 105-164.13(10a), (45), (45a), (45b), (45c), (55), and (56).
[63] Nucor.
[64] G.S. 105-164.13(10a); S.L. 1998-55.
[65] G.S. 105-164.3 and G.S. 105-187.51B use NAICS references. In those instances, the industry codes did not change with the most recent update. Therefore, no conforming changes were necessary.
[66] OMB is the White House office responsible for devising and submitting the president's annual budget proposal to Congress.

Sales Tax Refunds. – Section 4 expands the list of industries allowed an annual sales and use tax refund to include paper-from-pulp manufacturing[67] and turbine manufacturing.[68] This change became effective July 1, 2010, and applies to sales made on or after that date.

The General Assembly began offering sales tax exemptions to encourage companies to locate and expand in North Carolina[69] in 1998 when it granted a sales tax exemption to a major recycling facility[70] for the lubricants and other additives used at its facility for its machinery and equipment, for the electricity used at its facility, and for the materials and supplies consumed in the manufacturing processes at its facility.[71]

To be exempt, the business property must be located at the facility, it must be capitalized for tax purposes under the Code, and it must be used for one of the following purposes:

- For the provision of a service provided as part of its primary business.
- For the generation, transformation, transmission, distribution, or management of electricity.
- For the provision of related computer engineering or computer science research.

The owner of an Internet datacenter must forfeit the sales tax exemptions it has been allowed if it fails to meet the investment threshold, fails to locate and use the property at the datacenter, or fails to use the electricity at the datacenter. A taxpayer that forfeits an exemption is liable for all past taxes avoided as a result of the exemption, computed from the date the taxes would have been due if the exemption had not been allowed, plus interest. The past taxes and interest are due 30 days after the date the exemption is forfeited.

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[67] Governor Perdue announced on June 10, 2010, that Clearwater Paper Corporation would build a new tissue paper plant in Shelby, North Carolina.

[68] Siemens Energy announced plans to expand its Charlotte manufacturing plant for turbines and generators in March 2010.

[69] There are at least seven sales tax exemptions targeted to specific industries: G.S. 105-164.13(10a), (45), (45a), (45b), (45c), (55), and (56).

[70] Nucor.

[71] G.S. 105-164.13(10a); S.L. 1998-55.

[72] G.S. 105-164.3 and G.S. 105-187.51B use NAICS references. In those instances, the industry codes did not change with the most recent update. Therefore, no conforming changes were necessary.

[73] OMB is the White House office responsible for devising and submitting the president's annual budget proposal to Congress.

Sales Tax Refunds. – Section 4 expands the list of industries allowed an annual sales and use tax refund to include paper-from-pulp manufacturing[74] and turbine manufacturing.[75] This change became effective July 1, 2010, and applies to sales made on or after that date.

The General Assembly has allowed various industrial facilities to apply for an annual refund of the sales and use tax paid by them on building materials, supplies, fixtures, and equipment installed during the construction of a facility. Purchases for subsequent repair, renovation or equipment replacement do not qualify for the refund. The list of industrial facilities entitled to this refund has increased over the years:

- Air courier services. (1998)
- Aircraft manufacturing. (2004 and 2007)
- Bioprocessing. (2003)
- Computer manufacturing. (2004)
- Financial services. (2006)
- Motor vehicle manufacturing. (2004)
- Pharmaceutical and medicine manufacturing and distribution of pharmaceuticals and medicines. (2003)
- Semiconductor manufacturing. (2004)
- Solar electricity generating materials manufacturing. (2008)

To be allowed the refund, all of the listed industries must meet an investment threshold.[76] If the facility is located in a development tier one area, the required investment level is $50 million. For all other facilities, the investment level is $100 million. If the required investment level is not made within five years after the first refund is allowed, the facility loses its eligibility for the refund and must forfeit all refunds already received.[77] Only one of the listed industries must also meet a wage standard;[78] no industry listed must meet a specified employment level. A request for a refund must be made within six months after the end of the State's fiscal year. A refund applied for after the due date is barred. Under existing law, this refund provision will expire for all industries, including the newly added industries, for sales made on or after January 1, 2013.

1% Excise Tax, Subject to $80 Cap, on Certain Machinery & Equipment. – In 2007, the General Assembly substituted the 1%, $80 cap excise tax for the sales and use tax on certain purchases of machinery and equipment located and used at a datacenter.[79] This provision expires for sales occurring on or after July 1, 2013. To be taxed at the lower rate, the machinery and

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[74] Governor Perdue announced on June 10, 2010, that Clearwater Paper Corporation would build a new tissue paper plant in Shelby, North Carolina.

[75] Siemens Energy announced plans to expand its Charlotte manufacturing plant for turbines and generators in March 2010.

[76] The costs of construction may include the cost of acquiring and improving the land for the facility and the costs of the equipment for the facility.

[77] The owner of the facility is liable for past taxes due plus interest.

[78] Solar electricity generating materials manufacturing.

[79] S.L. 2007-323, Section 31.22. The 1% excise tax available to a datacenter does not apply to an "eligible Internet datacenter" to the extent the equipment and machinery of an Internet datacenter is exempt from sales tax.

equipment must be used to provide datacenter services or for the generation, transformation, transmission, distribution or management of electricity. To qualify for the reduced tax rate, a datacenter must meet the following requirements:

- Provide infrastructure for hosting or data processing services.[80]
- Satisfy the wage standard and health insurance requirements of Article 3J.[81]
- Meet a minimum investment threshold.[82] The minimum investment threshold is $150 million within five years for development tier one areas.[83] The investment threshold is $300 million for facilities not located in a development tier one area. A business that fails to meet the minimum investment threshold forfeits the lower tax rate provided by this Article and must pay all sales and use taxes, with interest, that would have been due on ineligible purchases.[84]

This act allows a datacenter to meet its $300 million investment threshold through the construction of two facilities. The act requires one facility to meet a large investment threshold of $225 million. Once a taxpayer qualifies for the lower 1% privilege tax by constructing a facility satisfying this large investment threshold, the taxpayer may also qualify for the lower tax rate on a second datacenter if all of the following requirements listed below are met. It also extends the sunset of this section from July 1, 2013, to July 1, 2015. The requirements are:

- The owner invests at least $75 million in the second datacenter.
- The two datacenters are linked through a fiber optic connection or a similar connection.
- The two datacenters are placed into service within five years of each other.

This act also adds a "contractor option" for the tax imposed on the machinery and equipment of a datacenter. Under this option, a contractor or subcontractor may elect to pay the lower 1% privilege tax rather than the sales and use tax on its purchases of machinery and equipment in connection with the datacenter. To make this election, the contractor or subcontractor must register with the Secretary of Revenue. An eligible contractor must purchase the machinery and equipment for use in performance of a contract with the owner of a datacenter. A subcontractor must purchase the machinery and equipment for use in performance of a contract with a general contractor that has a contract with the owner of a datacenter.

Sections 5 through 7 of the act make the following stylistic and clarifying changes to Article 5F:

- Incorporate the investment threshold, as well as the wage and health insurance requirements, in the statute providing the lower tax rate for a datacenter so that all of the provisions governing the applicable tax may be found in one statute. Section 5 removes the investment, wage, and health insurance requirements from the definitional statute for Article 5F.

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[80] G.S. 105-164.3(5c).
[81] G.S. 105-164.50(2)c.
[82] G.S. 105-164.50(2)b.
[83] The 3rd Edition of SB 1171 had removed the lower threshold because no company was currently taking advantage of the incentive, and it became known that the company for which the lower threshold was targeted was planning to locate in a development tier two or three county.
[84] A credit, in the amount of the privilege tax paid, is allowed against the sales and use taxes due following forfeiture, and interest is not computed against the amount of this offset. The past taxes and interest are due 30 days after the date of forfeiture.

- Clarify that the excise tax does not apply to equipment and machinery of an eligible Internet datacenter or software used in an eligible Internet datacenter that is exempt from sales tax. This provision is effective January 1, 2010. [85]

The 2001 General Assembly enacted Article 5F in response to the requirement of the Streamlined Agreement that states must simplify their sales tax rates.[86] The 2001 legislation repealed the 1% sales tax rate and $80 per article cap imposed on mill machinery and replaced it with a privilege excise tax having the same rate. Since that time, the Article has been expanded to tax other machinery and equipment at the lower rate, so long as the machinery and equipment are capitalized by the following companies for tax purposes under the Code:

- A major recycling facility. (2005)
- A research and development company in the physical, engineering, and life sciences. (2006)
- A software publishing company. (2007)
- An industrial machinery refurbishing company. (2008)

JDIG Changes. – Section 8 of the act authorizes the Economic Investment Committee charged with administering the JDIG Program to extend a business' base period by up to four years if the business has created and maintained at least 1,000 jobs. The current law remains in place if the business creates fewer than 1,000 jobs, which means that the Committee may extend the base period for up to two years. The act makes clear that under no circumstances may the base period be extended by more than four years. This section became effective when the Governor signed the act into law on July 11, 2010, and applies to all agreements in effect on or entered into after that date. This section expires January 1, 2013.

In 2002, the General Assembly created a new economic development tool for new and expanding businesses in North Carolina, the Job Development Investment Grant (JDIG) Program.[87] JDIG is used to attract businesses to the State by allowing a five-member Economic Investment Committee[88] (Committee) to award grants to businesses. The grants may be awarded over as many as 12 years, and the amounts of the grants are based on income tax withholdings from new jobs created by the businesses. The Committee may enter into no more than 25 agreements per calendar year and may commit no more than $15 million in any fiscal year under all agreements entered into during a single calendar year.

If a business that receives a grant fails to meet any condition or requirement set forth in its agreement, the Committee, in consultation with the Attorney General, must reduce the amount of the grant or the term of the agreement, may terminate the agreement, or both. The reduction of the grant amount or the term must be proportional to the failure to comply.

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[85] With this change, the clarifying language will have the same effective date as the change made in last year's budget regarding the sales tax exemption for certain "enterprise" software (Section 27A.3(f) of S.L. 2009-451). This effective date was requested by the Department of Revenue.

[86] S.L. 2001-347.

[87] Part II of S.L. 2002-172.

[88] The members of the Committee are the Secretary of Commerce, the Secretary of Revenue, The Director of the Office of State Budget and Management, and two public members appointed by the General Assembly, one upon the recommendation of the President Pro Tempore of the Senate and the other upon the recommendation of the Speaker of the House of Representatives. G.S. 143B-437.54.

If a business fails to maintain employment at the levels stipulated in the agreement or otherwise fails to meet a condition of the agreement for two consecutive years, one of two actions must be taken. The action taken will depend on whether the business is still within the "base period" established by the Committee and set forth in their agreement. If the business is no longer within the base period, the agreement must be terminated. If the business is still within the base period, the grant payment must be withheld for any consecutive year after the second consecutive year remaining in the base period in which the business fails to comply with any condition of the agreement. The Committee may extend the base period for up to two years, but under no circumstances may the term of the agreement be extended beyond the date set at the time the Committee awarded the grant.

Rev. Laws Technical & Admin. Changes.

Session Law	*Bill #*	*Sponsor*
S.L. 2010-95	**SB 1177**	**Senator Clodfelter**

AN ACT TO MAKE TECHNICAL, CLARIFYING, AND ADMINISTRATIVE CHANGES TO THE TAX AND RELATED LAWS.

OVERVIEW: This act makes technical, clarifying, and administrative changes to various tax statutes and related laws.

FISCAL IMPACT: No significant impact.

EFFECTIVE DATE: Except as otherwise specified, the act became effective when the Governor signed it into law on July 17, 2010.

ANALYSIS: This act makes the following changes:

Section	Explanation
VARIOUS TAX LAW CHANGES	
1	Corrects a reference.
2	Corrects a statutory cite.
3	Conforms the definition of "political party" in Chapter 105 to the definition in Chapter 163. When the General Assembly enabled taxpayers to designate part of their tax refund to a political party, the definition of "political party" in the tax statute conformed to the definition of "political party" in Chapter 163. The General Assembly changed the definition of "political party" in Chapter 163 in 2006, but failed to make a conforming change in Chapter 105. The two different definitions have led to confusion because the definition under Chapter 163 recognizes three political parties while the definition in the tax statutes recognizes only two political parties.
4	Allows a sales and use tax refund to a public library created by an act of the General Assembly. Unlike other public libraries that are part of a city or county government, the Public Library of Charlotte and Mecklenburg County is a creature of law. The General Assembly chartered the library in 1903 as a body corporate. Other public

	libraries are allowed an annual sales and use tax refund as part of a unit of local government. This section adds public libraries created pursuant to an act of the General Assembly to the list of governmental entities allowed an annual refund. Prior to 2008, the Public Library applied for semi-annual sales and use tax refunds as a charitable entity under G.S. 105-164.14(b). The General Assembly clarified the charitable refund provision in 2008 as applying to 501(c)(3) organizations to limit the expansion of the provision by a Court of Appeals decision in *The Lynnwood Foundation v. N.C. Department of Revenue*.[89] The Public Library of Charlotte and Mecklenburg County is not organized as a 501(c)(3) entity. The section is effective July 1, 2008, and applies to purchases made on or after that date. The retroactive effective date refers to the date that the 2008 clarifying legislation became effective.
5	Consolidates two subsections into one because both subsections define the retail value of a motor vehicle for purposes of the highway use tax.
6	Provides that a certificate of title issued as the result of a transfer to a revocable trust from an owner who is the sole beneficiary of the trust is exempt from the highway use tax. This transfer is essentially a transfer to the same owner. The current law currently exempts transfers to the same owner to reflect a name change.
7	*Reserved.*[90]
8	Consolidates two separate notices concerning taxes owed into one notice. The two notices are a notice of a proposed assessment of tax and a notice of a failure to pay penalty if the proposed assessment of tax is not paid within 45 days. Subsection (a) requires a notice of a proposed assessment of tax to inform the taxpayer that a failure to pay penalty will apply to the assessed tax if the assessment is not paid or protested within 45 days. This change streamlines the assessment process and eliminates the mailing costs for the current, separate notice of the failure to pay penalty. Subsection (b) clarifies that the protest of a proposed assessment applies to any failure to pay penalty imposed on the underlying assessment.
9	Clarifies a disputed tax amount must be paid before seeking judicial review.
10	Clarifies that the federal mailbox rule governs when a document that is mailed to the Department of Revenue is timely filed. Under the federal mailbox rule, documents submitted by mail to the IRS are considered to be filed on the date shown on the postmark stamped by the USPS. Under current NC law, a notice of appeal submitted to the Property Tax

[89] S.L. 2008-107.

[90] A section in a bill may be reserved to preserve the sequential numbering in a bill. It denotes that the section as currently written does not make any changes to the law. Sections may be reserved to accommodate changes that may be added to the bill at a later time or to reflect provisions that have been removed from the bill.

	Commission by mail is considered to be filed on the date shown on the postmark stamped by the USPS. However, in regards to other documents submitted to the Department, the issue is unclear. The statutes typically provide that a return or payment must be filed by a certain date or is due by a certain date. The Department has traditionally abided by the mailbox rule. As part of the Tax Appeals changes in 2007, G.S. 105-241.11 provides that requests for review of a denial of a refund or a proposed assessment are considered timely filed on the date the Department receives it. The Department believes the law is now unclear with regards to other filings. This section clarifies the law with respect to documents submitted by mail to the Department and it makes a conforming change to the Tax Appeals statute to remove any ambiguity.
11	Enables nonparticipating manufacturers to have access to the information that is used to determine their escrow payments, which are based upon the volume of tobacco product sales in this State.
12	Provides that a local sales tax rate may be changed on the first day of any calendar quarter so long as the county gives the Department of Revenue at least 90 days notice. Under prior law, a local tax rate change could only be made on the first day of either January or July. The General Assembly enacted that provision in July 2000 as part of the Streamlined Sales Tax Agreement changes. The Agreement, subsequently enacted in January 2001, provided for the quarterly dates and 60 days notice. Upon the request of the counties, this section conforms to the quarterly date allowed under the Agreement. Upon the request of the Department of Revenue, the act retains the 90-day notice requirement; the extra 30 days gives the Department the time it needs to notify retailers of the local sales tax change. (See temporary modification in Section 44.)
13	Repeals a redundant statute. G.S. 105-254 gives the Secretary of Revenue the authority to prepare the necessary forms, and to provide those forms upon request.
14	Corrects the reference to the Department of Human Resources to the Department of Health and Human Services; and directs DHHS to give the Secretary of Revenue the data the Department of Revenue needs to calculate the county hold-harmless payments required by G.S. 105-523 by February 24th and July 24th of each year. The State is required to make hold harmless payments to counties to ensure that each county benefits by at least $500,000 as a result of the provisions of the Medicaid swap, enacted in S.L. 2007-323. In calculating this hold-harmless amount, the Secretary must estimate Medicaid expenditures, based upon data provided to it by DHHS.
PROPERTY TAX CHANGES	
15	Clarifies that liens are extinguished when an historic structure is located on the site within the allowed statutory time period.

16	Amends the definition of "disabled veteran" to include a veteran whose death was the result of a service-connected condition and adds a definition for the term "service-connected."
17	Clarifies that no deferred taxes are due and all liens are extinguished on historic properties when the historical significance of the property is lost or impaired due to fire or other natural causes.
18	Clarifies that liens are extinguished when property is used for low or moderate income housing within the allowed statutory time period.
19	Removes the obsolete term "radio common carrier" from the definition of "public service company" in G.S. 105-333.
20	Adds a definition of "terminal" to the property tax statutes that govern the assessment and taxation of public service companies.
21	Clarifies the repeal of the builder's inventory property tax deferral does not affect the eligibility of certain property receiving the benefit.
22	Corrects an incorrect effective date for the combined motor vehicle system.
23-24	*Reserved.*[91]
MOTOR FUEL TAX CHANGES	
25	Expands the electronic funds transfer[92] (EFT) requirement to motor carriers and kerosene suppliers under Article 3 of Chapter 119. Since 1999, the State has required EFT of the following tax payments: taxes due by corporations that pay federal estimated tax by EFT, as well as sales tax prepayments, utilities franchise tax payments, and taxpayers of motor fuel taxes and alternative fuel taxes that must file the return electronically[93]
26	Changes the word "report" to "return" to more accurately reflect the type of document described.
27	Updates the reference to the International Fuel Tax Agreement (IFTA) from June 1, 2008, to June 1, 2010.
28	Provides that a motor carrier who wants to register in North Carolina as its base state under IFTA must be incorporated in this State or authorized to transact business in this State. This change imposes the same licensing restrictions on motor carriers that the State imposes on refiners, suppliers, terminal operators, and others.
29	Repeals some of the purposes for which a distributor may obtain a monthly refund for the motor fuel tax the distributor paid on kerosene used for a non-highway purpose. In most instances, kerosene used for a non-highway purpose will be dyed fuel, upon which the motor fuel tax has not been imposed. To the extent the motor fuel tax has been paid

[91] See the footnote for Section 7 of the act for an explanation regarding the term "Reserved."
[92] G.S. 105-163.40.
[93] G.S. 105-241(b).

	on the kerosene, an end-user of the fuel that uses the fuel for a non-highway purpose may continue to receive the benefit of the tax refund by applying annually for a refund of the motor fuel tax paid on the kerosene under G.S. 105-449.197. In 1994, the federal government began requiring motor fuel to be dyed if it was non-tax-paid fuel. The dyed fuel indicates that the fuel is used for a nontaxable purpose under federal law and for a non-highway use in North Carolina. Dyed fuel is not subject to either the federal or State excise tax on motor fuel. Effective July 1, 1998, the federal government began requiring diesel fuel to be dyed. Kerosene is defined as diesel fuel. By requiring kerosene to be dyed, the federal government provided a way to purchase kerosene for non-highway uses, such as heating, without having to pay the motor fuel excise tax on the fuel. At the time, the public feared that dyed kerosene could not safely be used in kerosene heaters and because of that fear many people would only use undyed kerosene. When North Carolina conformed to the federal law in 1998, it enacted this refund provision so as not to impose the motor fuel tax on kerosene, which was often used for heating purposes.[94] The fear that dyed kerosene would be unsafe for heaters has not materialized and the refund provision at the distributor level is no longer necessary since retailers who wish to sell kerosene for non-highway uses may purchase and sell dyed kerosene. Specifically, this section repeals the refund provided to a distributor who sells kerosene to a retailer and dispenses the kerosene into a dispensing device that is kept locked by the retailer and must be unlocked by the retailer for each sale of kerosene. The distributor is liable for any overpayment of the refund, even if the overpayment is attributable to an act of the retailer. It also repeals the refund provided to a distributor who sells kerosene to an airport to be used only for fueling airplanes because no tax has been refunded for this purpose for at least the past four years. This section becomes effective January 1, 2011, and applies to sales of kerosene made by a distributor on or after that date.
30	Removes a miscellaneous word created by a redlining error.
31	Subsection (a) provides a definition of taxicab that is substantially the same as the one that existed in G.S. 20-87(1), prior to repeal. Subsection (b) clarifies that the quarterly refund of motor fuel tax paid on fuel used to operate special mobile equipment (SME) is for the *non-highway* operation of the equipment and for equipment that is registered as SME under Chapter 20. This subsection becomes effective October 1, 2010, and applies to motor fuel purchased on or after that date.

[94]S.L. 1994-726 and S.L. 1998-146.

32	Provides that applications for refunds must be filed in the form required by the Secretary. This change will allow for the electronic filing of refund applications.
33-34	*Reserved.*[95]
OTHER RELATED LAW CHANGES	
35	Corrects a statutory reference.
36	Removed from the bill. The General Assembly enacted the substance of this provision in S.L. 2010-31, section 31.4.
37	Corrects a drafting error in S.L. 2009-520. This section became effective July 1, 2010; the same date S.L. 2009-520 became effective.
38	Removes a reference to the privilege tax imposed on manufacturing fuel because the tax no longer exists. This section became effective July 1, 2010, the date the privilege tax imposed on manufacturing fuel was repealed.[96]
39	Removes a duplicate subsection header.
40	Corrects an incorrect statutory reference.
41	Repeals a redundant provision. S.L. 2009-527 adjusted the local vehicle registration fee that may be imposed by a transit authority from $5 to $8 as part of an overarching plan designed to provide funding options to improve public transportation and to relieve transportation-related congestion, as recommended by the 21st Century Transportation Committee. The subsection being repealed states that a regional public transportation authority may not impose a vehicle registration fee that exceeds $5. The subsection not only conflicted with the 2009 law change but also became unnecessary in light of the 2009 law change.
42	Corrects an effective date error. Section 27A.3(b) of S.L. 2009-451 eliminated the delayed repeal of G.S. 105-269.14. G.S. 105-269.14 requires taxpayers to report and pay use tax annually on the individual income tax return. The elimination of the repeal means that taxpayers will continue to report and pay use tax annually on the individual income tax return. Section 27A.3.(c) amended the effective date of the original legislation enacted in 2000. By amending the effective date, the change inadvertently triggered a retroactive application of the way individuals would be required to pay the use tax between July 14, 2000, and August 7, 2009. To correct this interpretation, this section repeals Section 27A.3.(c) of S.L. 2009-451, as suggested by the codifier of the General Statutes.
43	Extends the moratorium on the collection of the 911 fee from prepaid wireless providers from the 2010 calendar year to the first nine months of the 2011 calendar year. The moratorium has been extended twice.

[95] See the footnote for Section 7 of the act for an explanation regarding the term "Reserved."
[96] See G.S. 105-187.51A.

44	Provides that during the 2010 calendar year, a local sales and use tax levied under Article 46 of Chapter 105 of the General Statutes may become effective on the first day of any calendar quarter so long as the county gives the Secretary at least 75 days advance notice of the new tax levy, rather than 90 days advance notice. Under the Streamlined Sales Tax Agreement, the notice requirement is 60 days. In earlier versions of this legislation, the 90-day notice provision was shortened to 60 days. (See summary for Section 12) A couple of counties[97] had a successful sales tax referendum this spring and hoped to implement the new rate October 1, based upon the 60-day notice period in the earlier versions of the legislation. This date could not be achieved with the 90-day notice provision. This provision gives the counties the ability to begin collecting sales tax at the higher rate with 75 days notice for the 2010 calendar year only.
EFFECTIVE DATE	
45	Except as otherwise noted, this act is effective when it becomes law. The Governor signed the legislation into law on July 17, 2010.

Remove Sunset/ Priv. Sale Local Gov't Bonds.

Session Law	*Bill #*	*Sponsor*
S.L. 2010-125	**HB 1936**	**Representative Owens**

AN ACT TO REMOVE THE SUNSET ON THE AUTHORIZATION TO SELL, THROUGH A PRIVATE SALE, LOCAL GOVERNMENT BONDS THAT ARE EITHER NOT RATED OR RATED BELOW "AA," SO AS TO CONTINUE TO TAKE ADVANTAGE OF THE FEDERAL "BUILD AMERICA BONDS" PROGRAM.

OVERVIEW: This act removes the sunset on the authorization to sell through a private sale local bonds that are either not rated or rated below "AA."

FISCAL IMPACT: This act has no fiscal impact.

EFFECTIVE DATE: This act became effective when the Governor signed it into law on July 21, 2010.

ANALYSIS: This act removes the December 31, 2010 sunset on the private sale of obligation bonds issued under the Local Government Bond Act that have been rated by a nationally recognized credit rating agency at a credit rating below "AA" or are unrated.

Bonds issued by units of local government must be sold by the Local Government Commission after advertisement and upon sealed bids, unless they meet one of nine statutory exceptions.[98]

[97] New Hanover and Wilkes Counties.

[98] Eight of the exceptions are as follows: (1) bonds that a State or federal agency has previously agreed to purchase; (2) bonds for which no legal bid is received within the time allowed for submission of bids; (3) revenue bonds and special obligations bonds issued under G.S. 159-84; (4) refunding bonds issued under G.S. 159-78; (5) refunding bonds issued under G.S. 159-72 if the Local Government Commission determines that a private sale is in the best interest of the issuing unit; (6) bonds that result in a tax credit

One of the exceptions is for general obligation bonds issued under the Local Government Bond Act that have been rated by a nationally recognized credit rating agency at a credit rating below "AA" or are unrated if they are sold before December 31, 2010. This exception was added to the statute in 2009[99] because of a provision in the *American Recovery and Reinvestment Tax Act of 2009* (ARRTA). ARRTA expanded the ability of banks to buy bonds issued by small local governmental units and certain nonprofit entities because those entities were facing considerable challenges in borrowing during the economic downturn. The federal provisions are scheduled to expire December 31, 2010. According to the State and Local Government Finance Division of the Office of the State Treasurer, allowing the private sale of general obligation bonds with no rating or rated below AA would enable local governments to take advantage of the debt issuance relief afforded under ARRTA. Presently, there is movement at the federal level to extend the relief given the continued uncertainty in the bond market. Lifting the current sunset date, in anticipation of the extension of the federal provisions, allows local governments to continue taking advantage of these instruments.

Construction of Wills and Trusts.

Session Law	*Bill #*	*Sponsor*
S.L. 2010-126	**SB 1176**	**Senator Clodfelter**

AN ACT TO CONSTRUE CERTAIN FORMULA CLAUSES THAT REFER TO FEDERAL ESTATE AND GENERATION-SKIPPING TRANSFER TAX LAWS.

OVERVIEW: This act construes certain formula clauses that reference federal estate and generation-skipping transfer tax laws that take effect in 2010, during which time there is no applicable federal estate or generation-skipping transfer tax, to refer to the applicable laws as they applied with respect to estates and trusts of decedents dying on December 31, 2009. The Revenue Laws Study Committee recommended this legislation.

FISCAL IMPACT: This act has no fiscal impact.

EFFECTIVE DATE: This act became effective when the Governor signed it into law on July 21, 2010.

ANALYSIS: Effective January 1, 2010, the federal estate tax and generation-skipping transfer tax law is repealed for one year. North Carolina imposes an estate tax on the estate of a decedent when a federal estate tax is imposed on the estate. Consequently, North Carolina's estate tax is also repealed for one year. The Fiscal Research Division estimates an $85 million loss of revenue associated with this repeal to the General Fund for fiscal year 2010-2011.

Many wills and trust agreements include formula provisions to determine what amounts of the estate will pass to different beneficiaries or to trusts for the benefit of different beneficiaries. These formula provisions are usually based upon the estate and generation-skipping transfer tax laws applicable at the time of the decedent's death. With the repeal of the federal estate

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to the owners under federal income tax laws if the Local Government Commission determines that a private sale is in the best interest of the issuing unit; (7) project development financing debt instruments; (8) bonds that are part of an issue in which the interest payment on some or all of the bonds is intended to be subsidized by payments from the federal government if the Local Government Commission determines that a private sale is in the best interest of the issuing unit.

[99] S.L. 2009-140; SB 754.

law for the year 2010, these provisions could result in a devise contrary to the decedent's intent. For example, a will or trust agreement could include a formula provision allocating the largest amount or percentage of the testator's estate that can pass free of estate tax to a "Family Trust" for the benefit of the testator's children and the remainder of the estate to a "Marital Trust" for the benefit of the testator's surviving spouse. In the absence of an estate tax, it is possible that this kind of provision could result in the entire estate passing to the Family Trust and nothing passing to the Marital Trust.

This act addresses the confusion and ambiguity in formula clauses caused by the repeal of the estate tax law for 2010 by generally putting people who die in 2010 in the position they would have been in if they had died on December 31, 2009. It also addresses instruments executed by a person who dies before 2010, but who left a document with formula language that takes effect in 2010. The act provides that a will or codicil, or trust instrument or amendment to a trust instrument, that refers to federal estate and generation-skipping transfer tax laws and becomes applicable during the time in which no such laws exist, will be construed to refer to the federal estate and generation-skipping transfer tax laws as they existed on December 31, 2009, unless the document clearly manifests an intent that a contrary rule applies. At least nine other states have adopted similar construction provisions.[100]

Homebuilder Property Tax Deferral Change

Session Law	*Bill #*	*Sponsor*
S.L. 2010-140	**HB 1249**	**Rep. Harrell, England**

AN ACT TO MODIFY THE INVENTORY PROPERTY TAX DEFERRAL.

OVERVIEW: This act modifies the homebuilders' inventory property tax deferral program by allowing residences constructed by a builder and owned by either the builder or a business entity of which the builder is a member to qualify for the deferral.

FISCAL IMPACT: This act has no fiscal impact.

EFFECTIVE DATE: This act is effective for taxes imposed for taxable years beginning on or after July 1, 2010.

ANALYSIS: In 2009, the General Assembly added for taxable years beginning on or after July 1, 2010, a property tax deferral program for occupant-ready residences constructed and owned by a general contractor for resale on a parcel of real property.[101] The amount of property tax liability that can be deferred is the portion of tax that represents the increase in the property value resulting from the construction of the residence on the property. This act modifies the ownership requirements for qualifying for the inventory tax deferral program. Under previous law, the property had to be owned by a builder. Interpretive conflicts arose in situations where a builder constructed a residence on property, the title to which was held by a business entity of which the builder was a member.[102] This act addresses that conflict and allows property so held to qualify for the deferral program.

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[100] Idaho, Indiana, Maryland, Nebraska, New York, South Dakota, Tennessee, Virginia, and Washington.
[101] S.L. 2009-308.
[102] "Member" is defined in G.S. 105-277.2 as a shareholder of a corporation, a partner of a general or limited partnership, or a member of a limited liability company.

Administrative provisions for the inventory tax deferral program are consistent with the other tax deferral programs and include (i) taxes that are deferred become a lien on the property, which is extinguished when the taxes are paid; (ii) the deferred taxes are due and payable on the day the property loses its eligibility for deferral as a result of a disqualifying event; (iii) interest accrues during the deferral period as of the date the taxes would have originally become due without the deferral program; and (iv) upon disqualification, the tax for a year in which a disqualifying event occurs is computed without the benefit of the deferral program. Applications for the deferral program should be filed within the regular listing period and may be filed later if the board of equalization and review determines there is good cause for the lack of timely filing.

The deferred taxes are carried forward in the records of the county and, if applicable, the city in which the property is located until the occurrence of one of four disqualifying events:

The builder transfers the residence.

The residence is occupied by the builder or another with the builder's consent.

Five years have passed from the time the improved property was first subject to listing for taxation by the builder.

Three years have passed from the date the improved property first received the property tax benefit provided by this deferral program.

Various Economic Incentives.

Session Law	*Bill #*	*Sponsor*
S.L. 2010-147	**HB 1973**	**Rep. Owens, Gibson, Wainwright, Brubaker**

AN ACT TO MODIFY EXISTING ECONOMIC DEVELOPMENT INCENTIVES AND TO INCENT NEW ECONOMIC DEVELOPMENT OPPORTUNITIES; TO PROVIDE FUNDING FOR THE DNA DATABASE AND DATABANK; AND TO ENCOURAGE THE USE OF MULTIPLE AWARD SCHEDULE CONTRACTS WHEN ISSUING REQUESTS FOR PROPOSALS FOR STATE CONTRACTS.

OVERVIEW: This act does the following:

Extends the sunset for the following tax credits:

- Article 3J of Chapter 105 of the General Statutes.
- Oyster shell recycling.

Enhances the film production tax credits.

Creates a new tax credit for interactive digital media.

Creates economic development incentives and favorable tax treatment for Eco-Industrial Parks.

Exempts certain wood chippers from sales tax.

Provides funding for the DNA Database and Databank.

Encourages the Department of Administration to consider the use of multiple award schedule contracts when issuing requests for proposals for State term contracts.

FISCAL IMPACT: Fiscal Research estimates a fiscal impact of $830,000 for fiscal year 2010-2011. Of the various incentives in this act, the expansion of the film production tax credit is estimated to have the most significant impact over the next five years reaching a General Fund loss of $56 million in fiscal year 2012-2013. *(For a more complete fiscal analysis, see NC 2010 Legislative Session Budget and Fiscal Policy Highlights. Available online:*

http://www.ncleg.net/fiscalresearch/highlights/highlights_pdfs/2010_Session_Highlights.pdf)

EFFECTIVE DATE: Except as otherwise stated, this act became effective when the Governor signed it into law on July 22, 2010.

ANALYSIS: This act enhances several of North Carolina's existing economic development tools and creates some new incentives. It is one of five acts the General Assembly passed this year to encourage economic development.[103]

Part I: Extend and Revise Tax Credits for Growing Businesses

Established to replace the Bill Lee tax credits, Article 3J provides credits for job creation and investment in real and business property. The credits became effective for tax years beginning on and after January 1, 2007.

Under prior law, Article 3J for growing businesses was scheduled to sunset for business activities that occur on or after January 1, 2011. In order to qualify for a number of economic incentives[104] offered by the State, including Article 3J, a taxpayer must meet an environmental impact test. In addition, under Article 3J, a taxpayer may receive a credit for investing in business property if the investment meets a specified threshold. The amount of the credit varies, depending upon the tier designation. Activities that occur in an agrarian growth zone may receive enhanced economic incentives.

This act makes three changes to Article 3J. First, it extends the sunset by two years from January 1, 2011, to January 1, 2013.

Second, it makes a technical change to the definition of an "agrarian growth zone." An agrarian growth zone is a zone that meets each of the following conditions: (i) it is comprised of one or more contiguous census tracts, census block groups, or both, in the most recent federal decennial census, (ii) all of the area is located in whole within a county that has no municipality with a population in excess of 10,000, and (iii) each census tract and each census block group that comprise the area has more than 20% of its population below the poverty level according to the most recent federal census. The act modifies the third requirement by allowing each census tract either to have more than 20% of its population below the poverty level or to be adjacent to another census tract or census block group in the zone that has more than 20% of its population below the poverty level according to the most recent federal census. The act further requires that the zone, as a whole, have more than 20% of its population below the poverty level according to the most recent federal census. This change is effective for taxable years beginning on or after January 1, 2011.

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[103] S.L. 2010-31; S.L. 2010-89; S.L. 2010-91; S.L. 2010-167.

[104] These incentives include site infrastructure development, JMAC (Job Maintenance and Capital Development Fund), and any tax incentive that incorporates, by reference, the environmental test set forth in Article 3J.

Third, the act clarifies what constitutes an environmental disqualifying event for purposes of qualifying for certain economic incentives. A taxpayer qualifies for certain economic incentives only if the taxpayer certifies that it has no pending administrative, civil, or criminal enforcement actions based on alleged significant violations of any DENR-implemented programs and has had no final determination of responsibility for any significant administrative, civil, or criminal violation of any DENR-implemented program within the last five years. These are civil and criminal violations with associated penalties. While Article 3J has a definition for what constitutes a "significant" violation, some confusion has arisen as to whether certain violations meet this definition. The Department of Revenue has interpreted the current language to make no distinction between civil and criminal violations or on the basis of whether the violation was knowing or knowing and willful. This act clarifies that for certain economic incentives[105] an environmental disqualifying event occurs when (i) a civil penalty is assessed by DENR for failure to comply with an order to abate or remediate a violation of any DENR program, (ii) a criminal penalty is imposed in connection with any DENR-implemented program, or (iii) DENR finds a taxpayer knowingly and willfully committed a violation of a DENR-implemented program, an assessment for damages to fish or wildlife is made, or a judicial order for injunctive relief was issued in connection with a violation of any DENR-implemented program.[106] This clarification is designed to ensure that minor violations do not inadvertently disqualify a taxpayer that would otherwise be eligible for a tax incentive and was vetted with the Departments of Commerce and Revenue. The clarification of a disqualifying environmental event for existing agreements is effective for credits claimed for taxable years beginning on or after January 1, 2007. The clarification of a disqualifying environmental event for new applicants became effective when the Governor signed the act into law on July 22, 2010, and applies to all agreements in effect on or entered into on or after that date.

Part II: Expand Tax Credits for Production Companies[107]

In 2005, the General Assembly replaced the film industry development grant program with a refundable income tax credit calculated based on the qualifying expenses spent by a production company in connection with a production.[108] The credit included a $1 million cap on employee compensation. In 2006, the General Assembly clarified that amounts paid to a highly compensated individual are not eligible for the credit regardless of whether paid directly by the production company or indirectly through another entity.[109] In 2009, the credit was modified to provide a production company with the choice of two different credit amounts: either a credit equal to 15% of qualifying expenses[110] or an alternative credit equal to 25% of qualifying

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[105] Article 3J, the Site Infrastructure Fund, and the Jobs Maintenance and Capital Development Fund (JMAC).

[106] The first two apply only for the tax year in which the activity occurred; the last includes the current tax year as well as the prior two tax years.

[107] The 2010 General Assembly further expanded the film credit in S.L. 2010-89. Section 1 of that act provides that a taxpayer is not required to add back to federal taxable income amounts allowed for the film credit.

[108] Section 39.1 of S.L. 2005-276.

[109] Section 4 of S.L. 2006-162. In the film industry, it is a customary practice to pay actors indirectly through a contract with a personal services company.

[110] Qualifying expenses are the total amount spent in North Carolina on (i) goods and services leased or purchased by a production company in connection with a production, (ii) compensation and wages paid by a production company on which it remitted withholding payments to the Department of Revenue, other than an amount paid in excess of $1 million to an individual, and (iii) the cost of production-related

expenses, less the difference between the amount of tax paid on purchases subject to the privilege tax on mill machinery under G.S. 105-187.51, which has historically been applied to cameras, film, props, building materials used in construction of sets, and chemicals/equipment used to develop and edit film, and the amount of tax the company would have paid on those purchases if they had been subject to the combined general rate of sales tax under G.S. 105-164.4.[111]

The refundable film credit is capped at $7.5 million. In order to obtain the credit, the taxpayer's qualifying expenses must exceed $250,000, which cannot include any amount in excess of $1 million in compensation paid to an individual. The credit is claimed for the taxable year in which the production activities are completed. The credit is computed based on all of the taxpayer's qualifying expenses incurred with respect to the production, not just the qualifying expenses incurred during the taxable year. If the credit exceeds the amount of tax imposed for the taxable year reduced by the sum of all credits allowable, the Secretary must refund the excess to the taxpayer. A pass-through entity is considered a taxpayer for purposes of claiming this credit.

Part II of this act does the following, effective for taxable years beginning on or after January 1, 2011:

Increases the applicable percentage used to calculate the credit from 15% of the amount of qualifying expenses to 25% of the amount of qualifying expenses and eliminates the alternative credit.

Allows a taxpayer to include as qualifying expenses both employee fringe contributions (including health, pension, and welfare contributions) and per diems, stipends, and living allowances paid for work being performed in the State.

Increases the cap of the film credit from $7.5 million to $20 million.

Clarifies that the scope of mill machinery for privilege tax purposes does not include purchases of cameras, film, props, building materials used in construction of sets, and chemicals/equipment used to develop and edit film. With this change, these purchases will be subject to the general rate of sales tax beginning January 1, 2011.

Part III: Tax Credit for Developing Interactive Digital Media

North Carolina does not provide any statutory incentive programs for companies that produce virtual world, flight, or training simulations or engines, platforms, or other programmed components of simulations. Effective for taxable years beginning on or after January 1, 2011, Part III of this act creates a new economic incentive to help recruit producers of interactive digital media (IDM) to North Carolina. The term 'interactive digital media' is defined as a product that meets all of the following requirements:

Produced for distribution on electronic media, including distribution by file download over the Internet.

Contains a computer-controlled virtual universe with which an individual who uses the program may interact in order to achieve a goal.

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insurance coverage obtained on the production. Expenses for insurance and coverage purchased from a related member may not be included as a qualifying expense.

[111] S.L. 2009-529.

Contains a significant amount of at least three of the following: text, sound, fixed images, animated images, and 3D geometry.

The credit is equal to a percentage of the taxpayer's expenses paid during the taxable year in developing the media, platform, or engine that exceed $50,000. The percentage amount varies as follows:

20% for expenses paid to a "participating community college," defined as a community college that offers an associate in applied science degree in simulation and game development, or to a research university.

15% for all other allowable expenses.

The credit is available only if the taxpayer meets the wage standard, health insurance, environmental impact, safety and health programs, and no-tax-delinquency requirements of Article 3J. IDM credits may be taken against either franchise or income tax liability. The taxpayer must elect which tax the credit will be claimed against when filing the return and that election is binding, including with respect to carryfowards. IDM credits may not exceed 50% of the amount of tax against which the credit is claimed, and unused portions of a credit may be carried forward for eight years. If a producer claims or has claimed an IDM credit with respect to a facility, that taxpayer is ineligible for One NC Fund and JDIG grants. This credit expires January 1, 2014.

Part IV: Extend Sunset for Recycling Oyster Shells Credit

This act extends the sunset on the tax credit for recycling oyster shells from January 1, 2011, to January 1, 2013. The General Assembly first enacted this credit in 2006[112] to offer an additional incentive to recycle oyster shells. Beginning October 1, 2009, oyster shells may not be disposed in landfills.

The credit is a nonrefundable income tax credit of one dollar for each bushel of oyster shells that a taxpayer donates to the Division of Marine Fisheries of the Department of Environment and Natural Resources. To be eligible for the credit, the taxpayer must provide the Department of Revenue with documentation, supplied by the Division of Marine Fisheries, verifying the donation and the number of bushels donated. The credit may be carried forward for five years. The taxpayer may not claim a deduction for any oyster shells for which a credit is claimed.

The Division of Marine Fisheries operates a voluntary oyster shell donation program. The Division of Marine Fisheries purchases oyster shells in very large quantities from shucking houses at a negotiated price per bushel.[113] Recycled oyster shells offer the following value: (1) aid in the restoration of oyster populations by their placement in sanctuaries and/or estuaries; (2) landscaping purposes; and (3) nutritional supplements.

Part V: Create Economic Development Incentives for Eco-Parks

Part V of this act provides new economic development incentives for Eco-Industrial Parks. To qualify as an Eco-Industrial Park, it must meet the following requirements: (i) it has at least 100 developable acres; (ii) it is located in a county that is not subject to motor vehicles emissions inspections; (iii) each building in the park meets the energy-efficiency and water usage standards established in G.S. 143-135.37; and (iv) each business in the park is in a clean industry. If these requirements are met, an Eco-Industrial Park will enjoy certain favorable treatment with regard to existing economic incentives. First, an Eco-Industrial Park has a

[112] S.L. 2006-66, Section 24.18.

[113] In 2006, the negotiated price was 50¢ per bushel.

development tier one designation for purposes of economic development programs. Second, for purposes of selecting applicants for the Job Development Investment Grant Program and selecting projects in a priority area for the NC Green Business Fund (Fund), an applicant or a project in an Eco-Industrial Park has priority over comparable projects that are not in an Eco-Industrial Park. Third, with respect to the Fund and unlike with other projects, the Department of Commerce may neither set a cap on a grant nor require matching funds for a grant from the Fund for projects in an Eco-Industrial Park. Fourth, the limitation on the tax credit for the installation of renewable energy property in nonresidential property is increased to $5 million per installation if the property is located in an Eco-Industrial Park. Under current law, the tax credit available against income, franchise, or gross premiums tax liability for taxpayers investing in renewable energy property for nonresidential property has a ceiling of $2.5 million per installation. Lastly, under current law, a taxpayer that has qualified research expenses is allowed a credit equal to the percentage of the expenses ranging from 1.25% to 3.25%.[114] This Part provides that the applicable percentage for expenses with respect to research performed in an Eco-Industrial Park is 35% of the expenses.

The priority treatment afforded projects in an Eco-Industrial Park with respect to grants under JDIG or the NC Green Business Fund applies to grant applications submitted on or after July 1, 2010. The remaining provisions such as the tier one designation and the tax credit changes are effective for taxable years beginning on or after January 1, 2011.

Part VI: Sales Tax Exemption for Wood Chippers

Under prior law, companies that produce wood chippers that are for use by out-of-state customers and that are immediately removed from North Carolina and are delivered to the customer's out-of-state location are required to collect sales tax for certain sales. This practice has, in practical effect, put these companies at a competitive disadvantage with similarly situated companies located in other States. These taxable sales included (i) where a customer's employee picks up the chipper at the company location using the customer's vehicle, (ii) where the customer pays a drive-away service driver to pick up the chipper at the company, and (iii) where the customer pays a drive-away service driver to pick up the chipper at the company using the customer's vehicle. These chippers are commercial units that are towed behind another vehicle and are assigned a vehicle identification number.

This act exempts from sales tax a wood chipper that meets all of the following requirements:

Is designed to be towed by a motor vehicle.

Is assigned a 17-digit vehicle identification number by the National Highway Transportation Safety Association.

Is sold to a person who purchases a motor vehicle in this State that is to be registered in another state and who uses the purchased motor vehicle to tow the wood chipper to the state in which the purchased motor vehicle is to be registered.

This Part became effective July 1, 2009, and applies to sales made on or after that date.

Part VII: Funding for the DNA Database and Databank

During the 2010 Session, the General Assembly enacted S.L. 2010-94, Collect DNA Sample on Arrest. Under this act, DNA samples will be taken from persons upon arrest for specified offenses, and the general method of sampling is changed from blood sample to cheek swab for all DNA sampling. Part VII of this act provides a funding mechanism for this new program.

[114] North Carolina university research expenses get a credit equal to 20% of the expenses.

A two-dollar ($2.00) criminal court cost will be assessed in every criminal case in Superior or District Court where the defendant is convicted, enters a guilty or nolo contendere plea, or when costs are assessed against the prosecuting witness. The cost does not apply to infractions. The funds are appropriated directly to the Department of Justice for the support and services of the SBI's DNA Database and DNA Databank.

The additional court cost becomes effective October 1, 2010, and applies to court costs imposed or collected on or after that date. However, in misdemeanor cases where the citation was issued before October 1, 2010, and the case is disposed of on or after that date by written appearance, by waiver of trial or hearing, or by plea of guilty or admission of responsibility, then the cost shall be the lesser of the cost specified in G.S. 7A-304(a), as amended by this act, or the cost specified in the notice portion of the defendant's copy of the citation. This Part also provides that if the $2.00 court cost is insufficient to fund the program, the Department of Justice must cover the additional costs through other funds appropriated to it and by applying for grants or seeking funds from the federal government or other sources.

Part VIII: Use of Multiple Award Schedule Contracts

This act encourages the North Carolina Department of Administration to consider the use of multiple award schedule contracts when issuing requests for proposals for State term contracts. This Part became effective when the act was signed into law by the Governor on July 22, 2010.

The use of multiple award schedules allows the government to leverage its purchasing power to garner volume discounts for commercial supplies and services, and it allows multiple vendors to compete and be awarded a contract based upon the value of their products or services. Under this process, vendors provide their total catalogue for lines of equipment and attachments to eligible purchasers, including State agencies, departments, institutions, public school districts, political subdivisions, and higher education facilities. The State then evaluates vendors based on a variety of factors, including discounts, total life cycle costs, service, warranty, distribution channel, and past vendor performance. Multiple award schedule contracts can result in competitive pricing, transparency, administrative savings, expedited procurement, and flexibility for State purchasers.

Sales Tax Changes/Study Competing Systems.

Session Law	*Bill #*	*Sponsor*
S.L. 2010-153	**HB 455**	**Rep. Insko, Bryant, Current, Neumann**

AN ACT TO ALLOW A SALES TAX REFUND TO A JOINT GOVERNMENTAL AGENCY CREATED TO OPERATE A CABLE TELEVISION SYSTEM.

OVERVIEW: This act allows cities that jointly operate a cable television system to obtain a refund of State and local sales and use tax paid by the entity on purchases made between July 1, 2007, and June 30, 2010. The request must be made in writing before January 1, 2011.

FISCAL IMPACT: The estimated fiscal impact of this provision for the State's General Fund is a revenue loss of less than $25,000; it also reduces local sales tax revenues by approximately $5,000. *(For a more complete fiscal analysis, see NC 2010 Legislative Session Budget and Fiscal Policy Highlights:* http://www.ncleg.net/fiscalresearch/highlights/highlights_pdfs/2010_Session_Highlights.pdf)

EFFECTIVE DATE: This act became effective when the Governor signed it into law on July 22, 2010.

ANALYSIS: Cities and counties may apply for an annual refund of the State and local sales tax paid by the governmental entity on direct and indirect purchases of tangible personal property, other than electricity and telecommunications service. Other governmental entities allowed this refund include various regional authorities and joint agencies created by interlocal agreements to operate a public broadcasting television station.

MI Connection is a locally owned and operated cable and Internet system serving the towns of Mooresville, Davidson and Cornelius in the counties of Mecklenburg and Iredell. The municipalities have created a joint agency through an interlocal agreement pursuant to G.S. 160A-462 to operate a cable television system. A cable television system is one of the listed systems that a municipality has the authority to operate as a public enterprise under Article 16 of Chapter 160A of the General Statutes.

Under current law, a city that operates a cable television system may obtain a sales tax refund of the purchases it makes. However, because the cities that operate MI Connection do so as a joint agency, they are not entitled to the sales tax refund. The only joint agency allowed a sales tax refund is one that operates a public broadcasting television station.

This act enables cities that have created a joint agency to operate a cable system that provides video programming to obtain a refund of State and local sales and use tax paid by the entity on purchases made between July 1, 2007, and June 30, 2010. Ordinarily, a request for a refund is due within six months of an entity's fiscal year, and it is barred if it is received more than three years after the due date. However, for purposes of the refund allowed by this act, the request must be made before January 1, 2011.

The act limits the refund provision to a specified time period in deference to the General Assembly's continued study of local government owned and operated communication systems. Senate Bill 1209 would have restricted the issuance by a local government of non-voted debt in the form of certificates of participation for the purpose of financing a communication system, such as a cable system or a system that provides internet access service. The General Assembly did not enact the restriction, but it did authorize the Revenue Laws Study Committee to continue to study local government owned and operated communication services.[115] The time period in the act corresponds to the time when MI Connection undertook large capital expenditures to begin the operations of the cable system.

Use of 911 Funds.

Session Law	*Bill #*	*Sponsor*
S.L. 2010-158	**HB 1691**	**Rep. Bryant, Faison, Sager, West**

AN ACT TO AMEND THE STATUTES GOVERNING EMERGENCY TELEPHONE SERVICE, AS RECOMMENDED BY THE HOUSE SELECT COMMITTEE ON THE USE OF 911 FUNDS, AND TO INCREASE FUNDS FOR SUPPLEMENTAL PEG CHANNEL SUPPORT.

OVERVIEW: This act makes various changes to the statutes governing Emergency Telephone Service, and increases the funding available for supplemental PEG channel support.

[115] S.L. 2010-152, Section 7.5.

FISCAL IMPACT: This act has no impact on General Fund revenues.

EFFECTIVE DATE: Except as otherwise provided, this act became effective July 1, 2010.

ANALYSIS:

911 Emergency Telephone Service

Prior to 2007, local government entities collected a 911 service charge from subscribers of local telephone providers, and the Wireless 911 Board collected a monthly service charge on each subscriber of wireless providers. The entire fee collected by local governments, and a portion of the fees collected by the Wireless 911 Board was distributed to "public safety answering points" (PSAP). Each PSAP is the public safety agency that receives incoming 911 calls and dispatches public safety agencies in response. Funds from the Wireless 911 Board not distributed to PSAPs were used to reimburse wireless providers for the costs of updating equipment necessary for PSAPs to geographically locate individuals who call 911 from wireless phones. In 2007, the local 911 service charge was eliminated and a new statewide administrative system was adopted for collecting the 911 service charge and distributing the funds. The 911 Board oversees the distribution of funds to PSAPs and wireless providers. The amount of the distributions to each eligible PSAP is based on the prior distribution to the PSAP from both the local service charge and the Wireless 911 service charge. Due to the differences in the fee that was previously collected on the local level, the distribution to some PSAPs was insufficient to cover actual costs while other PSAPs received distributions that far exceeded the actual cost of providing 911 service.

This act makes the following changes to the statutes governing Emergency Telephone Service:

The 911 Board. – The membership of the 911 Board is changed to increase the total number of local government representatives. One position representing a Commercial Mobile Radio Service (CMRS) provider, and one position representing the National Emergency Number Association (NENA) are removed. Two positions are added to the Board: a fire chief with experience operating or supervising a PSAP upon the recommendation of the NC Firemen's Association, and a Rescue or Emergency Medical Services Chief with experience operating or supervising a PSAP upon the recommendation of the NC Association of Rescue and Emergency Medical Services. The Act also prohibits Board members from serving more than two terms.

The Act amends the authority of the 911 Board to allow the Board to establish operating standards for PSAPs that receive distributions from the Fund, to create, design, or acquire public education materials regarding the proper use of 911, and to pay a private vendor for the provisioning of a network for the purpose of providing 911 service. The Board is authorized to increase from 1% to 2% the percentage of funds it retains for administrative expenses.

PSAP Distributions. – The 911 Board is authorized to determine the monthly distributions to eligible PSAPs. The distribution of funds to eligible PSAPS will be based on the cost of providing 911service, rather than on prior distribution levels. The new distribution amount is based on a formula adopted by the Board and is effective for distributions beginning in fiscal year 2011. The Board must notify each PSAP of the estimated distributions of the next fiscal year by December 31st of the prior year, and notify each PSAP of the actual amount of distributions by June 1.

Base amount formula: The Board must establish a formula to determine each PSAP's base amount. The formula must consider information including population, area served, and cost history.

Additional distributions: The Board may increase the distribution to a PSAP above its base amount if the PSAP receives less than its eligible costs in any fiscal year. The Board may not distribute less than the base amount unless the PSAP carries forward excess amounts.

Reconsideration: The Board must provide a procedure for a PSAP to request a reconsideration of its distribution or eligible expenses.

Carry forward: A PSAP may carry forward to the next fiscal year up to 20% of the total funds disbursed by the Board during a fiscal year for eligible expenditures for capital outlay, capital improvements, or equipment replacement. If more than 20% is carried forward, the Board may use the amount carried forward to lower the PSAPs annual distributions.

Fund Use and Fund Balance. – The use of the 911 Fund is expanded to include dispatch equipment within the building where the PSAP is located excluding the costs of base station transmitters, towers, microwave links and antennae used to dispatch emergency call information from the PSAP. The use is also expanded to include training specific for supervising and training a primary PSAP.

Due to the restriction on use of funds and the inequality in PSAP distributions under the prior law, some PSAPS have accumulated a large fund balance of distributed funds that are not required for eligible expenses. A PSAP may use 50% of its fund balance on July 1, 2010 for public safety needs, including costs that are not eligible expenses under G.S. 62A-46.

Statewide Projects. – The 911 Board is authorized to implement statewide projects for the benefit of 911 service. Under current law, surplus funds designated to be used for reimbursement for CMRS providers may be reallocated to the PSAP Grant Account. The Grant Account is redesignated the PSAP Grant and Statewide Projects Account. In order for the Board to use funds for a statewide project, the Board must determine the project is consistent with the 911 Plan, is cost effective and efficient when compared to the aggregated costs of similar projects if implemented by primary PSAPs, the expenses are eligible under the Fund, and the project has a statewide benefit.

Supplemental PEG Channel Support

S.L. 2007-151, the Video Service Competition Act, equalized the taxation of video programming services and replaced locally negotiated franchises of cable service with a State-issued franchise. The 2007 legislation distributed a portion of the sales tax revenue derived from video programming to cities and counties. The distributions are made quarterly. City and county revenue from the video programming tax has exceeded the projections of anticipated revenue.

G.S. 105-164.44l(b) designates $2 million of the video programming sales tax revenue distributed to cities and counties for Supplemental PEG channel support.[116] Up to $6,250 per quarter ($25,000 per year) may be distributed for each certified channel. The amount distributed per PEG channel depends on the total number of PEG channels certified. For the first quarter of 2010, there were 107 certified PEG channels. Each certified channel eligible to receive funding received $4,672.90 for that quarter.

[116] A PEG channel is a channel set aside by a cable operator for public, educational, or governmental use. To receive a distribution of the Supplemental PEG channel support funds, a city or county must certify the PEG channels provided to the city or county for its use.

Although the amount of sales tax revenue has exceed expectations, the amount distributed per PEG channels has been less than anticipated due to a greater number of certified PEG channels than expected. The 2007 legislation anticipated there would be excess revenue dedicated to PEG channel support. Excess revenues not expended for Supplemental PEG support would be transferred to the PEG Grant Fund, administered by e-NC Authority.[117] With the higher number of PEG channels, there are not excess Supplemental PEG support revenues to transfer to the PEG Grant Fund.

This act repeals the PEG Grant Fund and increases the revenues from the video programming sales tax designated for Supplemental PEG channel support to $4 million per year. Cities and counties must continue to certify PEG channels and may certify up to three PEG channels. The yearly cap on funding per PEG channel is removed. Each PEG channel will receive a proportional share of the total revenues available. Based on the number of certified PEG Channels in the first quarter of 2010, each PEG channel would receive approximately $9,300 per quarter. The repeal of the PEG Grant Fund was effective July 1, 2010. The increase in Supplemental PEG Channel support is effective July 1, 2011.

Economic Incentives Alignment & Changes.

Session Law	*Bill #*	*Sponsor*
S.L. 2010-166	**SB 1215**	**Senator Jenkins**

AN ACT TO INCREASE UNIFORMITY IN SUNSET AND REPORTING REQUIREMENTS OF ECONOMIC INCENTIVES TOOLS AND TO ELIMINATE NONUTILIZED ECONOMIC INCENTIVES.

OVERVIEW: This act, which was a recommendation of the Revenue Laws Study Committee, does the following:

- Harmonizes sunset and reporting features and requirements across the State's various economic incentives.
- Creates a single, unified economic incentives report that contains the information currently reported separately for each economic incentive.
- Deletes obsolete credits under Articles 3C and 3G of Chapter 105 of the General Statutes.

FISCAL IMPACT: Fiscal Research estimates no fiscal impact for fiscal year 2010-2011. For subsequent fiscal years, Fiscal Research estimates a fiscal impact of roughly $2.14 million. *(For a more complete fiscal analysis, see NC 2010 Legislative Session Budget and Fiscal Policy Highlights. Available online:*

http://www.ncleg.net/fiscalresearch/highlights/highlights_pdfs/2010_Session_Highlights.pdf)

[117] A grant may only be used for capital expenditures necessary to provide PEG channels. The size of a grant may not exceed $25,000, and an applicant may receive no more than one grant per fiscal year. The applicant must match the grant on a dollar-for-dollar basis. The Authority must publish an annual report on the grants awarded from the Fund.

EFFECTIVE DATE: This act became effective July 1, 2010, and included effective date language that ensures that sales and use tax refund eligibility are not affected.

ANALYSIS: Under prior law, many of the economic incentives enacted as the Article 3 credits, the income tax credits in Article 4, and the sales and use tax benefits in Article 5 had some combination of reporting requirements[118] and sunset provisions; however, those requirements were not uniformly set out in each incentive. Where reporting requirements were set out, there were inconsistencies with respect to itemization by taxpayer,[119] itemization by credit,[120] the reporting entity,[121] and other miscellaneous differences.

In addition, there were two economic incentives that were either never utilized or were no longer being utilized. The first was the credit in Article 3C for large recycling facilities, which was intended for Wisconsin Tissue; however, that company never located in North Carolina. The second credit was for major computer manufacturing facilities in Article 3G. Other than the Dell facility for which the credit was enacted, no other taxpayer utilized that credit.

Part I of the act requires data on each of the State's economic incentives to be reported in a single economic incentives report and establishes sunsets for various economic incentives, as provided in the chart below. Part II of the act eliminates obsolete economic incentives. Part III of the act makes conforming changes to various statutory provisions. The following table describes the changes in more detail by section number of the act:

Section Number(s)	Effect
1.2	Adds requirement of itemization by taxpayer and by credit to the Art. 3B (Business and Energy Tax Credits) report.
1.4, 1.6	Adds requirement of itemization by taxpayer to Arts. 3D (Historic Rehabilitation Tax Credits) and 3E (Low-Income Housing Tax Credits) report, respectively.
1.8	Creates reporting requirement for Art. 3H (Mill Rehabilitation Tax Credits).
1.13	Transfers reporting requirement for G.S. 105-130.46 (credit for exporting cigarettes and increasing employment) from the corporation claiming the credit to DOR and harmonizes reporting requirements.
1.17, 1.18, 1.19, 1.20	Separates and categorizes the current sales and use tax refunds, all of which are currently found in G.S. 105-164.14, into three types of refunds: (1) refunds that were enacted for non-industrial facilities for economic incentives purposes (found

[118] Currently, there is no reporting requirement for Article 3H or for sales and use tax refunds for analytical services, for railroad intermodal facilities, or for vehicle parts for motorsports racing teams.
[119] While itemization by taxpayer for economic incentives credits is generally required, it is not currently required by the reporting requirements of Articles 3B, 3D, or 3E.
[120] Both Articles 3B and 3J contain multiple credits. While Article 3J's reporting provisions require itemization by credit, Article 3C's reporting provisions do not.
[121] Generally speaking, the reporting entity is the Department of Revenue for each economic incentives report required; however, the reporting entity differs for Article 3C (in which Revenue and Commerce jointly report) and for the credit for utilizing State ports to export cigarettes while increasing employment (in which the corporation claiming the credit reports).

	in the newly created G.S. 105-164.14A), (2) refunds that were enacted for industrial facilities for economic incentives purposes (found in the newly created G.S. 105-164.14B), and (3) refunds that were not enacted for economic incentives purposes (remaining in G.S. 105-164.14)[122].
1.21	Creates the economic incentives report.
1.1, 1.2, 1.3, 1.4, 1.6, 1.7, 1.9, 1.10, 1.11, 1.12, 1.13, 1.14, 1.15, 1.16	Makes conforming and technical changes to the reporting requirement necessary to transfer the current, separate reports into a new, unified annual report.
1.5, 1.18	Proposes sunsets for Art. 3D historic rehabilitation credit (2014), and for the sales and use tax refund for low-tier machinery (aligns sunset to Art. 3J), motorsports racing vehicle parts (2014), analytical services supplies (2013), and railroad intermodal facilities (2038).
2.1	Eliminates credit for large recycling facilities.
2.2	Repeals Art. 3G (Tax Incentives for Major Computer Manufacturing Facilities).
Part III	Makes conforming changes.

Renewable Energy Incentives.

Session Law	*Bill #*	*Sponsor*
S.L. 2010-167	**HB 1829**	**Representative Luebke**

AN ACT TO PROMOTE THE USE OF RENEWABLE ENERGY BY EXTENDING THE CREDIT FOR CONSTRUCTING RENEWABLE FUEL FACILITIES AND THE CREDIT FOR BIODIESEL PRODUCERS, REVISING THE TAX CREDIT FOR INVESTING IN RENEWABLE ENERGY PROPERTY, REINSTATING AND EXPANDING THE TAX CREDIT FOR A RENEWABLE ENERGY PROPERTY FACILITY, CLARIFYING THE AUTHORITY OF LOCAL GOVERNMENTS TO FINANCE ENERGY PROGRAMS, CLARIFYING THAT REAL PROPERTY DONATED FOR A CONSERVATION PURPOSE CAN BE USED ONLY FOR THAT PURPOSE, AND TO DESIGNATE THE APPROPRIATE PERSON TO PROVIDE A WRITTEN ALLOCATION OF THE FEDERAL §179D TAX DEDUCTION FOR ENERGY EFFICIENT COMMERCIAL BUILDINGS OWNED BY A GOVERNMENTAL ENTITY.

OVERVIEW: This act, which embodies the energy incentive legislation enacted this session, does the following:

[122] Session Laws 2010-31 and 2010-91 extended the repeal dates from 2011 to 2013 for interstate passenger air carriers and aviation fuel for motorsports events and added pulp-to-paper manufacturing and turbine manufacturing to the industries eligible for sales tax refunds, respectively. However, these changes were not incorporated into Session Law 2010-166. A technical correction will be included in the 2011 Revenue Laws Technical Changes bill to adjust the repeal dates.

Extends credits for constructing renewable fuel facilities and biodiesel producers.

Modifies the credit for investing in renewable energy property by amending the definitions and adding combined heat and power property to the credit.

Reinstates and expands the credit for a renewable energy property facility.

Clarifies the local government authority to finance energy programs.

Clarifies that real property donated for conservation purposes may only be used for those purposes.

Clarifies who is responsible for making the allocation of the federal §179D tax deduction.

FISCAL IMPACT: The act will reduce General Fund revenues by $0.7 million in fiscal year 2010-2011 and $1.3 million in fiscal year 2011-2012. *(For a more complete fiscal analysis, see NC 2010 Legislative Session Budget and Fiscal Policy Highlights. Available online:*

http://www.ncleg.net/fiscalresearch/highlights/highlights_pdfs/2010_Session_Highlights.pdf)

EFFECTIVE DATE: Except as otherwise noted, this act became effective when the Governor signed it into law on August 2, 2010.

ANALYSIS:

Extension of Credit for Constructing Renewable Fuel Facilities and Credit for Biodiesel Producers. – The General Assembly enacted a credit for constructing renewable fuel facilities in 2004.[123] The credit includes a 15% credit for the costs of constructing a facility for dispensing renewable fuel and a 25% credit for the costs of constructing a facility for producing renewable fuel. In 2006, the sunset was extended until January 1, 2011, and an enhanced credit was created for taxpayers that invest at least $400 million in three separate facilities over a five-year period.[124]

The General Assembly enacted a tax credit for certain biodiesel providers in 2006.[125] In order to qualify for the credit, the provider must be a producer of biodiesel (as opposed to an importer) that produces at least 100,000 gallons of biodiesel during the taxable year. The amount of the credit is equal to the per gallon excise tax paid by the producer on the biodiesel. The credit is repealed for taxable years beginning on or after January 1, 2010.

Section 1 of the act extends the sunset for both credits. Each credit is repealed for taxable years beginning on or after January 1, 2013.

Changes to Credit for Investing in Renewable Energy Property. – Under current law, the credit for investing in renewable energy property applies to biomass equipment, hydroelectric generators, solar energy equipment, wind equipment, and geothermal heat pumps and equipment. The amount of the credit for investing in renewable energy property is 35% of the cost of the property placed in service. In the case of renewable energy property that services a single-family dwelling, the credit must be taken for the taxable year in which the property is placed in service. For all other renewable energy property, the credit must be taken in five equal installments, beginning with the taxable year in which the property is placed in service. The amount of the credit is subject to certain limits depending on the type of property and

[123] S.L. 2004-153.
[124] S.L. 2006-66, Section 24.7.
[125] S.L. 2006-66, Section 24.8.

whether the property is placed in service in a residential or nonresidential setting. The credit will sunset on January 1, 2016.

Section 2 of the act makes the following changes to the credit for investing in renewable energy property:

Amends the definition of "cost" to follow the federal definition under the Internal Revenue Code. Prior to the act, the cost of leased property was determined by multiplying the annual rent by eight.[126] This definition is the same one that is used under the Bill Lee Act and Article 3J. In some instances, a developer will structure a project in such a way as to elect for federal purposes to pass through the federal tax credit to an affiliated entity that is leasing the equipment. In these instances, the actual cost of the renewable energy property and installation can be greater than the amount derived by multiplying the annual rent by eight. This change to the definition will allow a person who elects to pass through the federal credit to use the actual cost of the property when calculating the tax credit.

Creates a definition for the term "installation" that is consistent with the interpretation of the term by the Department of Revenue in private letter rulings. The tax credit is limited to $2.5 million per nonresidential installation. Because the term "installation" was not defined, investors routinely sought rulings from the Department of Revenue for clarification of this term and its application to particular projects. The Department had defined installation as "renewable energy property that standing alone or in combination with other machinery, equipment, or real property is able to produce usable renewable energy on its own."

Adds combined heat and power equipment to the types of property that is eligible for the credit. Combined heat and power equipment produces heat and electricity simultaneously. The paper and pulp industry is the primary State industry that uses combined heat and power equipment.

Amends the definition of wind turbine to include equipment used in relaying the electricity produced by a wind turbine by cable to the power grid.

Makes other technical and conforming changes to the statute.

This section of the act is effective for taxable years beginning on or after January 1, 2010.

Reinstate and Expand Credit for Renewable Energy Property Facility. – Prior to 2006, a corporation that constructed a facility in North Carolina for the manufacture of renewable energy equipment such as solar energy and wind equipment could receive a corporate income tax credit for the costs of constructing the facility.[127] The credit was equal to 25% of the installation and equipment costs of construction paid during the taxable year. This credit, which was never used, was repealed for costs incurred during taxable years beginning on or after January 1, 2006. Renewable energy equipment was defined as biomass equipment, hydroelectric generators, solar energy equipment, and wind equipment.

Section 3 of the act reinstates and expands the credit for a renewable energy property facility. The credit is also expanded to include a facility for the manufacture of major component subassembly for a solar array or a wind turbine facility. The credit is equal to 25% of the cost to the taxpayer of converting a facility, or 25% of the costs to the taxpayer of constructing and

[126] G.S. 105-130.4(j)(2).

[127] This credit is distinguished from the credit in Section 2 of this act in that this credit is for constructing a facility that manufactures renewable energy equipment or property as opposed to a credit for the placement into service of such equipment or property once manufactured.

equipping the facility. Renewable energy property includes biomass equipment, combined heat and power equipment[128] hydroelectric generators, geothermal equipment, solar energy equipment, and wind equipment. The credit may be taken against the franchise tax or the income tax. The entire credit must be taken in five equal installments, beginning with the taxable year the facility is placed in service. If the facility is disposed of, or taken out of service, the taxpayer may not take any remaining installments. The credit is subject to the following limitations:

> The credit may not exceed 50% of the tax against which it is claimed for the taxable year. Any unused portion of the credit may be carried forward for the succeeding five years.
>
> A taxpayer that claims any other credit with respect to the construction of a facility to manufacture renewable energy property may not take this credit with respect to the same facility.

This section is effective for taxable years beginning on or after January 1, 2010, and sunsets for facilities placed in service on or after January 1, 2014.

Clarify Local Government Authority to Finance Energy Programs. – In 2009, the General Assembly authorized cities and counties to establish loan programs to finance energy efficiency improvements and the installation of distributed renewable energy sources that are permanently affixed to real property.[129] North Carolina cities and counties were eligible to obtain federal grant funds under the *American Recovery and Reinvestment Act of 2009* (ARRA), during the 2009-2011 biennium to finance certain energy-related programs. The Energy Efficiency Conservation Block Grants Program (EECBG) sought to assist eligible entities to reduce fossil fuel emissions, to reduce total energy use, and to improve energy efficiency in transportation and buildings. Cities and counties may use EECBG funds and any other unrestricted funds for the program. The loans may be used for energy efficiency improvements and the installation of distributed renewable energy sources that are permanently affixed to commercial and residential real property. The term of the loans may not be greater than 15 years, and the annual interest rate charged on the loans may not exceed 8%. The term "renewable energy source" has the same meaning as "renewable energy resource" in G.S. 62-133.8.[130]

Section 4 of the act clarifies that cities and counties may establish loan loss reserve funds to finance energy improvements, and may establish other energy programs funded through federal grants. This section also clarifies that cities and counties may use State and federal grants and loans, and property taxes for the financing program.

Clarify Use of Real Property Donated for a Conservation Purpose. – The General Assembly first enacted the conservation income tax credit in 1983. The credit is allowed to a taxpayer that donates real property for public beach access or use, public access to public waters or trails, fish and wildlife conservation, or other similar land conservation purposes. To qualify for the credit, 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. The amount of the credit is 25% of the fair market value of the donated property interest, capped at $250,000 for individuals and

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[128] Combined heat and power equipment is added under the changes in Section 2 of this act.
[129] S.L. 2009-522.
[130] That definition does not include peat, fossil fuel, or nuclear energy resources, but does include solar electric, solar thermal, wind, hydropower, geothermal, ocean current or wave energy resource, biomass resource, waste heat, and hydrogen derived from a renewable energy resource.

$500,000 for corporations. This credit was taken by an individual after donating ocean front property in Currituck County to the Audubon Society, an organization whose mission is to conserve and restore natural ecosystems. The Audubon Society is currently seeking to sell the donated property to a group that plans to turn the property into a development that will include a hotel, shops, and condominiums.

Section 5 of the act clarifies that donations of real property must be for a qualifying use listed in the statute, and the donation must be subject to a perpetual restriction on the use of property.

Allocation of Federal §179D Tax Deduction for Energy Efficient Commercial Buildings Owned by a Governmental Entity. – To encourage businesses to incorporate energy efficiency into their operational plans, Congress enacted the section 179D energy tax deduction as part of the Energy Policy Act of 2005. This deduction relates to the design and construction of energy-efficient commercial buildings. The deduction allows a taxpayer to take an immediate expense, subject to a cap, for the cost of energy-efficient improvements that would normally take years to recover through depreciation. To qualify, energy-efficient improvements must reduce total annual energy and power costs with respect to interior lighting systems and heating, cooling, ventilation, and hot water systems by 50%. The deduction is allowed for the taxable year the property is placed in service, and it expires for property placed in service after December 31, 2013. [131] North Carolina also allows this deduction.[132]

For energy-efficient commercial building property expenditures made by a public entity, the IRS issued guidance on March 12, 2008, that allows the deduction to be allocated to the person primarily responsible for designing the property in lieu of the public entity. Some believe the deduction is underutilized in North Carolina for energy efficient property placed in governmental buildings owned by the State because designers do not know how to obtain the governmental allocation. Section 6 of the act clarifies the Secretary of Administration is the person responsible for providing the written allocation to the designer for property owned by the State.

Low-Profit Limited Liability Company.

Session Law	*Bill #*	*Sponsor*
S.L. 2010-187	**SB 308**	**Senator Jacumin**

AN ACT TO PROVIDE FOR THE FORMATION OF A LIMITED LIABILITY COMPANY AS A LOW-PROFIT LIMITED LIABILITY COMPANY.

OVERVIEW: This act recognizes a new type of corporate designation known as a low-profit limited liability company (L3C).

FISCAL IMPACT: This act has no fiscal impact.

EFFECTIVE DATE: This act became effective when the Governor signed it into law on August 3, 2010.

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[131] The deduction was originally set to expire for property placed in service after December 31, 2007. Congress extended the sunset until December 31, 2013.

[132] North Carolina, as part of the IRC Update legislation of 2006, conformed to this federal tax law deduction. The State also conformed to the extension of the sunset when it enacted the IRC Update legislation in 2009.

ANALYSIS: Chapter 57C of the North Carolina General Statutes provides for the formation of a limited liability company (LLC). A low-profit limited liability company is a LLC that is formed for both a business purpose and a charitable purpose that requires operation of the company in accordance with these three requirements:

> To accomplish one or more charitable or educational purposes within the meaning of section 170(c)(2)(B) of the Code.
>
> To operate so that no significant purpose of the company is the production of income or the appreciation of property.
>
> To operate so that no purpose of the company is to accomplish one or more political or legislative purposes within the meaning of section 170(c)(2)(D) of the Code.

A LLC may choose to put these conditions on its operations by including them in its articles of organization and by operating in accordance with them. This act allows a company that meets these requirements to call itself a "low-profit limited liability company" and to use the designation "L3C."[133] Like a LLC, a L3C is subject to federal and State tax and investments in a L3C are not tax deductible.

The formation of a L3C is designed to facilitate program-related investments (PRI) by private foundations. Private foundations must distribute at least 5% of their capital for charitable purposes to maintain their nonprofit status. Although foundations often expend these funds through grants, they may also meet the expenditure requirement with IRS-sanctioned PRIs. A PRI is an investment that supports charitable activities but may involve the potential return of capital. An example of a PRI is a loan, a loan guarantee, and an equity investment in a charitable organization.

Foundations do not usually make PRIs without an IRS private letter ruling that the investment meets the IRS requirements as an acceptable PRI. The expense of obtaining a private letter ruling deters foundations from this form of investment. The founders of the L3C designation hope that the IRS or Congress will choose to treat an investment in a L3C as a PRI without the need for a private letter ruling because the three requirements to form as a L3C mirror the IRS requirements for a PRI. Neither the IRS nor Congress has evidenced any movement on this issue.

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[133] Vermont became the first state to recognize the L3C as an official legal structure in April 2008, and Michigan become the second state in January 2009.

2009

MODIFY CORPORATE APPORTIONMENT FORMULA.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-54	**SB 575**	**Senator Hoyle**

AN ACT TO ENCOURAGE THE LOCATION AND EXPANSION OF CAPITAL INTENSIVE COMPANIES IN THIS STATE BY PROVIDING FOR APPORTIONMENT OF CORPORATE INCOME BASED SOLELY ON THE SALES FACTOR FOR COMPANIES THAT MEET CERTAIN INVESTMENT AND QUALITY JOBS CRITERIA.

OVERVIEW: This act changes the corporate income tax apportionment formula used by a capital intensive multistate corporation meeting specific investment criterion from a three-factor formula based upon property, payroll, and double-weighted sales to a single sales factor formula. The apportionment formula determines the amount of a multistate corporation's income that may be taxable by North Carolina. A single sales factor formula reduces the income tax liability of a corporation with relatively large shares of its nationwide property in North Carolina but a relatively small share of its nationwide sales in North Carolina.

FISCAL IMPACT: The act reduces General Fund revenues by approximately $3 million annually beginning in fiscal year 2011-2012. The loss could become as great as $12.5 million a year by fiscal year 2018-2019. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2009 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The act is effective for taxable years beginning on or after January 1, 2010.

ANALYSIS: A corporation that does business in more than one state must pay income tax to each of the states in which it has nexus. The U.S. Supreme Court cases have upheld the right of states to tax the income of multistate corporations so long as the income is fairly sourced to the taxing state. The conventional method used by states to source income has been the apportionment formula, which is used to derive an apportionment percentage. Generally speaking, a taxpayer multiplies its taxable income by its apportionment percentage to determine the amount of its income sourced to a state. The state's corporate income tax rate is applied to the corporation's income apportionable to that state.

Most states use an apportionment formula based on or substantially similar to the Uniform Division of Income for Tax Purposes Act (UDITPA).[1] The UDITPA formula is a composite of three factors: a property factor, a payroll factor, and a sales factor. The property factor represents the ratio of the taxpayer's real and tangible personal property in the taxing state to its real and tangible personal property everywhere. Likewise, the payroll factor and the sales factor represent a ratio of the taxpayer's payroll and sales in the taxing state to its payroll and sales everywhere. Under UDITPA, the sum of the three factors is divided by three, resulting in a taxpayer's apportionment percentage.

[1] UDITPA dates back to 1957.

North Carolina shifted to a double-weighted sales factor apportionment formula in 1988 at the request of RJR Nabisco.[2] A double-weighted sales factor tends to favor home-state industries that have a concentration of their total facilities in a state but sell their products all over the country. Under North Carolina's current apportionment formula, the payroll and property factors are each weighted 25% and the sales factor is weighted at 50%; the sum of the four factors is divided by four.

This act creates a single sales factor apportionment formula at the request of Apple, who plans to build a major East Coast data center in Maiden, NC.[3] Apple will invest at least $1 billion in the infrastructure hub and it is expected to employ 50 full-time employees.4 Under the single sales factor formula, the total allocation of a corporation's nationwide profits to North Carolina is solely based on where the corporation's sales occur. 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.

The act limits the single sales factor apportionment formula to a 'qualified capital intensive corporation'. The act defines a 'qualified capital intensive corporation' as one that meets all of the requirements listed below. At the time the General Assembly considered this legislation, no taxpayer met these requirements. However, it is anticipated that Apple will meet these requirements. The act provides that if no corporation has met these requirements by January 1, 2019, the single sales factor provision is repealed.

- The corporation's property factor must meet one of the following conditions:
  - The property factor as a percentage of the sum of the factors in North Carolina's double weighted sales factor apportionment formula must exceed 75%.
  - The average property factor for the preceding three years as a percentage of the average sum of the double weighted sales factor apportionment formula must exceed 75%.
- The Secretary of Commerce makes a written determination that the corporation has invested or is expected to invest at least $1 billion in private funds to construct a facility in this State within nine years of the time that construction begins.
- With respect to the facility that meets the $1 billion investment threshold, it must:
  - Be located in a county designated as a tier one or tier two area at the time construction began.[5]

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[2] RJR Nabisco had plans for a large automated bakery in the Garner area. After the change was adopted, RJR Nabisco was bought out and forced to cut back on capital expenditures. The company never built the plant.

[3] Although the identity of the company was not made public during the legislative deliberations, Governor Perdue issued a press release on June 3, 2009, the same day she signed Senate Bill 575 into law, announcing that Apple selected North Carolina as the location for a new data center. Apple announced in July that it would locate the data center in Catawba County, in the town of Maiden. It had also considered locating the facility in Cleveland County.

[4] The Department of Commerce projects that a data center investment of $1 billion will create more than 3,000 jobs in the regional economy over the next 10 years.

[5] Catawba County is designated as a tier 2 area in 2009.

- Maintain the average number of employees it has at the facility during the first two years after the facility is placed in service for the remainder of time in which the corporation must complete the required $1 billion investment.
- Meet the weekly wage standard set out in Article 3J.[6] The applicable weekly wage standard for Catawba County in 2009 is $592.
- Provide health insurance for all full-time jobs at the facility.[7]

The act provides that a qualified capital intensive corporation must forfeit the benefit of the single sales factor apportionment formula prospectively if it fails to make the required investment in capital facilities within nine years. It does not require the recapture of any benefits already received. The act also provides that a qualified capital intensive corporation is ineligible for Article 3J tax credits[8] a grant from the Job Development Investment Grant Program[9] or a grant from the One NC Fund[10] with respect to a facility that met the $1 billion investment threshold. Lastly, the act encourages qualified capital intensive corporations to utilize the Employment Security Commission and cooperating local agencies as a first source for recruitment of employees.

In 2006 and 2007, the General Assembly enacted exemptions from the sales and use tax for data centers that meet certain conditions[11] In January of 2007, Google announced its decision to invest $600 million in a new facility in Caldwell County in Lenoir, North Carolina.[12] G.S. 105-164.13(55) exempts an eligible Internet data center from sales tax on electricity and on certain business property located and used at the data center. G.S. 105-187.51C imposes a privilege tax, in lieu of a sales tax, on certain equipment and machinery purchased by an eligible data center. The rate of tax is 1% of the sales price of the equipment and machinery, capped at $80 per article. To be an eligible Internet data center under G.S. 105-164.13 or an eligible data center under G.S. 105-187.51C, a facility must meet certain use, location, wage, employee insurance benefits, and investment conditions. If Apple meets the conditions of these exemptions, it would be eligible for them as well as the modified corporate apportionment formula.

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[6] G.S. 105-129.83 provides that a job in a tier two area satisfies the wage standard if it pays an average weekly wage that is at least equal to the lesser of one hundred ten percent (110%) of the average wage for all insured private employers in the State and ninety percent (90%) of the average wage for all insured private employers in the county.

[7] Under G.S. 105-129.83, a taxpayer provides health insurance if it pays at least fifty percent (50%) of the premiums for health care coverage that equals or exceeds the minimum provisions of the basic health care plan of coverage recommended by the Small Employer Carrier Committee pursuant to G.S. 58-50-125.

[8] See Article 3J of Chapter 105 of the North Carolina General Statutes.

[9] See Part 2G of Article 10 of Chapter 143B of the North Carolina General Statutes.

[10] See Part 2H of Article 10 of Chapter 143B of the North Carolina General Statutes.

[11] Section 24.17 of S.L. 2006-66 and Section 31.22 of S.L. 2007-323.

[12] North Carolina also provided a grant to Google under the Job Development Investment Grant Program. The grant required the company to create 200 jobs in four years. In December 2008, Google withdrew its application for the grant incentive because it could not meet the job creation criteria. As of December 2008, the company had approximately 50 employees at the data center located in Lenoir, NC.

ADD DIVISION OF LESS TO CCPS.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-81, as amended by S.L. 2009-550	**HB 201** **HB 274**	**Rep. Spear, R. Warren**

AN ACT TO FACILITATE THE TRANSFER OF MOTOR VEHICLES FROM THE UNITED STATES DEPARTMENT OF DEFENSE TO LOCAL GOVERNMENT UNITS, VOLUNTEER FIRE DEPARTMENTS, AND VOLUNTEER RESCUE SQUADS AND TO CLARIFY THAT THE DIVISION OF LAW ENFORCEMENT SUPPORT SERVICES IS A DIVISION OF THE DEPARTMENT OF CRIME CONTROL AND PUBLIC SAFETY.

OVERVIEW: This act provides exemptions from the highway use tax for State agencies acting as a pass-through for vehicles received through a United States Department of Defense program that are subsequently transferred to an emergency response unit, a law enforcement agency, or fire department. S.L. 2009-550 establishes the retail value of a vehicle transferred through this program for purposes of the highway use tax as the price paid by the purchaser of the vehicle rather than the market value of the vehicle.[13] The remainder of this act does not affect North Carolina tax laws and is not discussed below.

FISCAL IMPACT: No impact. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2009 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective when the Governor signed it into law on June 11, 2009. The clarifying change in S.L. 2009-550 became effective when the Governor signed it into law on August 23, 2009.

ANALYSIS: Federal law provides programs through which vehicles are disbursed from the Department of Defense to emergency response units, local law enforcement, and fire departments.[14] The Federal programs require a state agency to facilitate the transfer of these vehicles. The Department of Crime Control and Public Safety (DCCPS) has been operating one of these programs for over 15 years. Last year, the DCCPS facilitated the transfer of over $1 million in vehicles to local law enforcement through this program.[15] A similar program facilitated by the Department of Environment and Natural Resources (DENR) has been in operation for the past two years and has facilitated the transfer of approximately 90 vehicles.

When vehicles under this program are initially transferred, the department facilitating the program does not take title to the vehicle. The ultimate recipient, which is either an emergency response unit, local law enforcement, or a fire department, takes title to the vehicle and pays the highway use tax. If the recipient decides the vehicle is no longer needed, the vehicle is transferred to the department facilitating the program for transfer to another emergency

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[13] Section 2.(e) of S.L. 2009-550, AN ACT TO MAKE VARIOUS CLARIFYING CHANGES TO THE GENERAL STATUTES AND SESSION LAWS.

[14] 10 U.S.C. §381 establishes procedures under which states and units of local government may purchase law enforcement equipment for counter-drug activities through the Department of Defense. 10 U.S.C. § 2576b establishes procedures under which states may purchase personal property to assist firefighting agencies.

[15] Section 17.5 of S.L. 2009-451 established a fee that a local law enforcement agency must pay to the Department of Crime Control and Public Safety for equipment it receives through the Department from the United States Department of Defense. The fee amount is set by the DCCPS. (see G.S. 143B-475.2)

response unit, local law enforcement, or fire department in the State. During this subsequent transfer, the department may take title, at which point the department would be required to pay highway use tax.

The highway use tax is payable when a person applies for a certificate of title for a motor vehicle. The rate of tax is 3% of the retail value of the vehicle. The retail value of a vehicle is its sales price if the vehicle is sold by a retailer. Otherwise, the retail value of a vehicle is its market value, which is presumed to be the value of the vehicle as set in a schedule of values adopted by the Commissioner of Motor Vehicles.

The program operated by DCCPS was momentarily halted this year after the Division of Motor Vehicles raised concerns about whether the facilitating agency should obtain title to the vehicles when initially transferred, and if so, whether the facilitating agency should pay the highway use tax. The question also arose as to the retail value of the vehicle, for purposes of the highway use tax, since the price paid for the vehicle may be less than its market value. This act, and S.L. 2009-550, resolve these issues.

Section 1 of this act and Section 2(b) of S.L. 2009-550 exempt the facilitating department from the requirement under G.S. 20-73 to apply for a certificate of title within 28 days of the transfer of the vehicle.[16] This exemption will allow both DCCPS and DENR to transfer vehicles under the federal programs without first obtaining title to the vehicle. If the agency does not have to obtain a title, it does not have to pay the highway use tax. Sections 2(a), (b), and (d) of S.L. 2009-550 also exempt the facilitating agency from the mileage and damage disclosure requirements of Chapter 20 of the North Carolina General Statutes.

Section 2 of this act exempts the facilitating agency from paying highway use tax when it obtains title to a vehicle from a unit of local government, volunteer fire department, or volunteer rescue squad for the purpose of transferring the vehicle to another unit of local government, volunteer fire department, or volunteer rescue squad. Section 2(e) of S.L. 2009-550 sets the retail value of a vehicle transferred under this federal program as the price paid for the vehicle rather than its market value.

STATE TREASURER INVESTMENTS.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-98	**SB 703**	**Senator Rand**

AN ACT CONCERNING INVESTMENTS OF THE STATE TREASURER.

OVERVIEW: This act, requested by the Office of the State Treasurer, gives the State Treasurer more flexibility to invest special funds[17] held by the State Treasurer, with the goal of increasing portfolio return and better managing risk.

FISCAL IMPACT: No impact.

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[16] A person who fails to apply for a certificate of title within the required time frame is subject to a $15 civil penalty and is guilty of a Class 2 misdemeanor.

[17] These special funds are listed in G.S. 147-69.2 and include, among others, the various State and local governmental employee retirement systems. The employee retirement systems are supported by investment returns, employee contributions, and employer contributions.

EFFECTIVE DATE: This act became effective when it was signed into law by the Governor on June 11, 2009.

ANALYSIS: The State Treasurer has statutory authority to invest certain special funds held by the Treasurer in excess of the amount required to meet the current needs and demands of these funds. Authorized investments are outlined by statute in G.S. 147-69.1(c)(1)-(7) and G.S. 147-69.2(b). This act provides the Treasurer with more flexibility and tools to invest these funds as follows:

- Authorizes the investment of funds in obligations that are convertible into equity securities. These are non-investment grade securities. These newly authorized investments, as well as the currently authorized investment in obligations, must bear one of the four highest ratings of at least one nationally recognized rating service when acquired. The act deletes the requirement that the obligations must not bear a rating below the four highest by any nationally recognized rating service that rates the particular security. (See G.S. 147-69.2(b)(4)).
- Permits investment in asset-backed securities that bear a rating below the four highest by any nationally recognized rating service that rates the particular securities. (See G.S. 147-69.2(b)(6)).
- Requires the Treasurer to invest assets of the Retirement Systems[18] so that no less than 20% of these assets are at all times invested in investments authorized by G.S. 147-69.2(b)(1)-(6). This liquidity requirement is designed to ensure that funds are available to meet the cash needs of the Retirement Systems. (See G.S. 147-69.2(b)(6a)).
- Authorizes the Treasurer to make investments pursuant to G.S. 147-69.2(b)(1)-(6) directly, or indirectly through contractual arrangements as long as the indirect investment is managed by an investment manager that has assets under management of at least $100,000,000. (See G.S. 147-69.2(b)(6b)).
- Authorizes the Treasurer to invest the assets of the Retirement Systems in obligations and other debt securities, including debt securities convertible into other securities, that do not meet the investment requirements of G.S. 147-69.2(b)(1)-(6) and (7) as long as these investments in credit opportunities meet all of the following requirements:
    - The investments must be made through the following investment entities or vehicles: investment companies registered under the Investment Company Act of 1940, individual, common collective trust funds of banks and trust companies, group trusts and limited partnerships, limited liability companies or other limited liability investment vehicles that invest primarily in investments authorized by G.S. 147-69.2(b)(6c) and through contractual arrangements. If the investment is through a contractual arrangement, the investment manager for each investment must have assets under management of at least $100,000,000.
    - The investments may not exceed 5% of the market value of all invested assets of the Retirement Systems.

  (See G.S. 147-69.2(b)(6c))

[18] The following systems are referred to collectively as the Retirement Systems: the Teachers' and State Employees' Retirement System, the Consolidated Judicial Retirement System, the Firemen's and Rescue Workers' Pension Fund, the Local Governmental Employees' Retirement System, the Legislative Retirement System, and the North Carolina National Guard Pension Fund.

- Authorizes the investment of Retirement Systems' assets in equity securities traded on a public securities exchange or market organized and regulated under the laws of the jurisdiction of the exchange or market. Prior law permitted investment only in preferred or common stock. These investments are still capped at 65% of the market value of all invested assets of the Retirement Systems, but the act removes the 5% cap on assets that may be invested in the stocks or shares of a diversified investment company registered under the Investment Company Act of 1940. So long as each investment manager manages assets of at least $100,000,000 (was $50,000,000), Retirement Systems assets may be invested through the following:
    - Investment companies registered under the Investment Company Act of 1940.
    - Individual, common, or collective trust funds of banks and trust companies.
    - Group trusts.

  The act adds the following investments to this list:
    - Contractual arrangements in which investment managers have full and complete discretion and authority to invest assets specified in such contractual arrangements.

  (See G.S. 147-69.2(b)(8))
- Authorizes the Treasurer to directly invest Retirement Systems' assets in any equity securities represented in the S&P 500 Index or that have been publicly announced to be included in the S&P 500 Index. The act eliminates certain statutory limitations on the investments of Retirement Systems' assets. The act, however, maintains the requirement that no more than 1½% of the market value of the Retirement Systems' assets be invested directly in the stock of a single corporation, and the total number of shares in that corporation not exceed 8% of the issued and outstanding stock of the corporation. Prior to this legislation, all stock management was outsourced. The Treasurer will still outsource most stock management, but the direct management of some funds should allow the Treasurer greater access to market data and savings in fees. (See G.S. 147-69.2(b)(8)).
- Authorizes the Retirement Systems' assets to be invested in inflation resistant assets such as commodities, timberlands, real estate, and treasury inflation protected securities.[19] As some of the other investments authorized by this act, these investments must be made through investment companies registered under the Investment Company Act of 1940, individual, common or collective trust funds of banks and trust companies, group trusts and limited liability investment vehicles and through contractual agreements in which the investment manager has full discretion and authority to invest Retirement Systems assets in these investments. For each investment allowed under G.S. 147-69.2(b)(9a), the investment manager must manage assets of at least $100,000,000, and the investments authorized under subdivision (9a) must not exceed 5% of the market value of all invested assets of the Retirement Systems. (See G.S. 147-69.2(b)(9a)).

The act permits the Treasurer to use fees assessed under G.S. 147-69.2((b2) and (b3) to defray the cost of administering these investments. Subsection (b2) applies to the investment of public

[19] The cash flows from treasury inflation protected securities are based on inflation; as inflation sets in periodic interest payments increase.

hospital funds deposited with the Treasurer, and subsection (b3) applies to the investment of UNC Hospitals at Chapel Hill funds deposited with the Treasurer.

The remaining changes to G.S. 147-69.2 are conforming and technical.

TEMPORARY FLOOR FOR MOTOR FUELS TAX RATE.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-108	**SB 200**	**Senator Jenkins**

AN ACT TO ESTABLISH A MINIMUM MOTOR FUELS TAX RATE FOR TWO YEARS.

OVERVIEW: This act establishes a minimum variable rate of 12.4¢ a gallon for calculation of the motor fuel tax rate, applicable for the period July 1, 2009, through June 30, 2011. With a minimum variable rate of 12.4¢, the motor fuel tax rate may be greater than 29.9¢ per gallon but it may not be less.

FISCAL IMPACT: The act increases revenue $50 million for fiscal year 2009-2010 and it is expected to increase revenue $17.5 million for fiscal year 2010-2011. Three-fourths of the revenue derived from the excise tax on motor fuel is allocated to the Highway Fund and the remaining quarter is allocated to the Highway Trust Fund.[20] *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2009 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective when the Governor signed it into law on June 15, 2009.

ANALYSIS: This act establishes a minimum motor fuel tax rate of 29.9¢ a gallon for the period July 1, 2009, through June 30, 2011, by providing that the variable component of the rate may not be less than 12.4¢ a gallon. The motor fuel tax rate consists of a flat rate of 17.5¢ per gallon plus a variable rate based upon the average wholesale price of motor fuel. With a minimum variable rate of 12.4¢, the rate may be greater than 29.9¢ per gallon, but it may not be less.

The variable component of the motor fuel tax rate is equal to the greater of 7% of the average wholesale price of motor fuel during a base six-month period or 3.5¢ per gallon. The base six-month period for the motor fuel rate applicable on and after July 1 ends March 31. The base six-month period for the motor fuel rate applicable on and after January 1 ends September 30. Based upon the average wholesale price of motor fuel for the base period April 1, 2008, through September 30, 2008, the motor fuel rate effective on and after July 1, 2009, would have been 27.8¢ a gallon.

In 2006, the General Assembly capped the variable wholesale component of the motor fuels tax at 12.4¢ per gallon, the wholesale rate for the period of January 1, 2006, through June 30, 2006.[21] The General Assembly extended the cap in 2007 from July 1, 2007, through June 30, 2009.[22] With the cap, the rate could be less than 29.9¢ per gallon, but it could not be

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[20] One-half cent per gallon of the excise tax is allocated to various environmental funds. The remaining revenue is allocated to the Highway Fund or the Highway Trust Fund.

[21] Section 24.3 of S.L. 2006-66. Section 2.2(g) of S.L. 2006-66 provided a reserve in the General Fund for the purpose of holding harmless the Highway Fund and the Highway Trust Fund in the event that the variable wholesale component of the tax would have exceeded 12.4¢ per gallon.

[22] Section 31.15 of S.L. 2007-323.

greater. During this period, the rate fell to 29.7¢ per gallon for the period July through December 2007. Otherwise, it stayed at 29.9¢ per gallon.

CHANGES FOR BONDS AUTHORIZED UNDER ARRTA.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-140	**SB 754**	**Senator Clodfelter**

AN ACT TO AMEND THE NORTH CAROLINA GENERAL STATUTES TO ALLOW THE STATE TO TAKE FULL ADVANTAGE OF THE EXPANSION OF EXISTING BOND PROGRAMS AND THE CREATION OF NEW BOND PROGRAMS UNDER THE AMERICAN RECOVERY AND REINVESTMENT TAX ACT OF 2009 (ARRTA).

OVERVIEW: This act does two things:

- It authorizes local governments to issue several types of government bonds established under the American Recovery and Reinvestment Tax Act of 2009 (ARRTA).
- It authorizes the private sale of general obligation bonds that have a credit rating below "AA" or that are unrated and that are issued prior to December 31, 2010.

FISCAL IMPACT: No fiscal impact.

EFFECTIVE DATE: This act became effective when the Governor signed it into law on June 19, 2009.

ANALYSIS:

Authorize new bonds. – This act authorizes local governments to issue several types of government bonds[23] established under ARRTA. Bonds under these programs are either tax-exempt[24] bonds or tax credit bonds. Tax credit bonds are a recent alternative to traditional tax-exempt bonds. They are not interest-bearing obligations; instead, a taxpayer holding a tax credit bond is allowed a credit against federal income tax equivalent to the interest that the bond would otherwise pay. The bondholder must include the amount of the credit in gross income and treat it as interest income. The credit effectively replaces the interest that would be paid on an exempt bond, allowing the issuer to borrow interest-free. The types of bonds authorized under ARRTA are:

- **Build America bonds.** – Unlike tax credit bonds, which provide a tax credit in lieu of interest payments, build America bonds pay interest to the bondholders and also provide a tax credit. The bondholder must include the interest in gross income, but is

[23] State and local bonds are classified as either governmental bonds or private activity bonds. Governmental bonds are primarily used to finance governmental functions and are repaid with governmental funds. Interest on these bonds is generally exempt from federal and State income tax. Private activity bonds are bonds that allow the state or local government to serve as a conduit for providing financing to nongovernmental entities. Interest on private activity bonds is not excluded from gross income for federal income tax purposes unless the bonds fall within certain defined categories.

[24] Federal law limits the amount of certain types of tax-exempt bonds that may be issued each year in the State. North Carolina has established the North Carolina Federal Tax Reform Allocation Committee (Committee) to manage the federal allocation and to decide which of the local bonds may be issued if the demand exceeds the supply. The Committee consists of the Secretary of the Department of Commerce, the Executive Assistant to the Governor for Budget Management, and the Treasurer.

allowed a credit against federal income tax liability for a portion of the interest payments received. The tax credit is equal to 35% of the interest payable on the interest payment date of the bond. These bonds must be issued before January 1, 2011. State and local governments may elect to receive a direct payment in the form of a refundable credit in lieu of the credit to the bondholder.

- **Qualified school construction bonds.** – ARRTA provides bond authority to states and local governments for school infrastructure through two primary tax credit bond programs: a new qualified school construction bond program and the extension of the qualified zone academy bond (QZAB) program.

  North Carolina's QZAB program is currently administered by the State Board of Education. The national volume cap for these bonds is $11 billion for 2009 and another $11 billion for 2010. There is also an annual cap allocated among the states based on their respective populations of individuals below the poverty line. North Carolina's QZAB allocation for 2009 is $44.1 million.

  The State Board of Education will also administer the statewide allocation of qualified school construction bonds, which are to be issued in the same manner and under the same guidelines as the QZABs. The statewide allocation to North Carolina under ARRTA for these bonds is approximately $187.2 million.[25] A bond is a qualified school construction bond if all of the following conditions are met:

  - 100% of the available project proceeds of the issue of which it is a part are to be used for the construction, rehabilitation, or repair of a public school facility or to acquire land on which a facility funded by the same issue is to be built.
  - The bond is issued by a state or local government within the jurisdiction of which the school is located.
  - The issuer designates the bond as a qualified school construction bond under section 54F of the Internal Revenue Code.

- **Recovery zone facility bonds.** – Recovery zone facility bonds are a type of qualified private activity bond, the interest income of which is tax-exempt. The national limitation on the amount of these bonds that may be issued before January 1, 2011 is $15 billion. The IRS will allocate the national amount to the states based on an amount that bears the same ratio to the total limitation that its employment decline for 2008 bears to the aggregate of the 2008 employment declines for all of the states.

  A recovery zone facility bond is any bond issued before January 1, 2011 and where 95% or more of the net proceeds of the issue are to be used for recovery zone property. Recovery zone property is depreciable property constructed, reconstructed, renovated,

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[25] ARRTA provided that the 100 largest school districts in the United States are to receive a percentage of the total amount of bonds authorized. The following counties will receive a part of this special allocation:

- Mecklenburg - $25.96 million
- Cumberland - $15.95 million
- Forsyth - $12.24 million
- Guilford - $17.15 million
- Wake - $17.30 million

or acquired by purchase by the taxpayer after the date on which the recovery zone designation took effect where substantially all of the use of the property is in a recovery zone and is in the active conduct of a qualified business by the taxpayer in the zone. A recovery zone is (1) any area designated as having significant poverty, unemployment, rate of home foreclosures, or general distress; (2) any area designated by the issuer as economically distressed by reason of the closure or realignment of a military installation; or (3) any area for which a designation as an empowerment zone or renewal community is in effect.

- **Recovery zone economic development bonds.** – Recovery zone economic development bonds are a type of qualified bond, which entitles the county or municipal issuer to elect to receive a 45% tax credit for the interest paid on the bond. Up to $10 billion in these bonds may be issued nationally before January 1, 2011. It is estimated that $351.7 million will be allocated to North Carolina. The proceeds of the bonds are to be used for qualified economic development purposes defined as expenditures for promoting development or other economic activity in a recovery zone.

- **Qualified energy conservation bonds.** – Qualified energy conservation bonds are a new type of tax credit bond authorized under the Emergency Economic Stabilization Act of 2008. These bonds provide a federal subsidy to assist state and local governments in financing energy conservation projects with respect to capital expenditures, research expenditures, expenses for mass commuting facilities, demonstration projects that promote green building technology, and other technologies that promote energy efficiency. ARRTA expands the program by increasing the national cap from $800 million to $3.2 billion. North Carolina's allocation is $95.7 million.

Conform Federal Tax Reform Allocation Committee. – This act also amends the Article governing the Federal Tax Reform Allocation Committee (Committee) to reflect the addition of recovery zone facility bonds, recovery zone economic development bonds, and qualified energy conservation bonds under ARRTA. With this change, the Committee is authorized to manage the allocation of these new bonds and to study the ways in which these bonds can be utilized.

Authorize private sale of certain general obligation bonds. – Bonds issued by units of local government must be sold by the Local Government Commission (LGC) after advertisement and upon sealed bids, unless they meet one of the statutory exceptions. Under prior law, the following types of bonds could be sold at private sale:

- Bonds that a state or federal agency has previously agreed to purchase.
- Any bonds for which no legal bid is received within the time allowed for submission of bids.
- Revenue bonds and special obligation bonds issued pursuant to Chapter 159I of the General Statutes.
- Special obligation refunding bonds.
- Refunding bonds issued pursuant to G.S. 159-72, if the LGC determines that a private sale is in the best interest of the issuing unit.
- Bonds designated as qualified zone academy bonds pursuant to G.S. 115C-489.6, if the LGC determines that a private sale is in the best interest of the issuing unit.
- Project development financing debt instruments.

This act adds to the above list general obligation bonds issued pursuant to the Local Government Bond Act that have been rated by a nationally recognized credit rating agency at a credit rating below "AA" or that are unrated if they are sold prior to December 31, 2010.

The act also authorizes the private sale of bonds that are part of an issue in which the interest payments on some or all of the bonds are intended to be subsidized by payments from the federal government under federal tax laws, if the LGC determines that a private sale is in the best interest of the issuing unit. The purpose of this language is to permit the use of build America bonds, in which the interest subsidy is paid directly by the U.S. Treasury to the issuer of the obligations.

Conform Industrial and Pollution Control Facilities Financing Act. – The act makes conforming changes to the Industrial and Pollution Control Facilities Financing Act to take into account the recovery zone facility bonds authorized under ARRTA.

The Industrial and Pollution Control Facilities Financing Act authorizes the issuance of tax-exempt industrial development and pollution control bonds. Under this Act, a local political subdivision issues bonds, the proceeds of which are used to finance the acquisition and construction of industrial, pollution control, or other capital facilities to be used by a private company. The bonds are secured by and are sold exclusively on the basis of the company's obligation to make payments under a financing agreement entered into between the company and the political subdivision. Because the interest on the bonds is exempt from North Carolina and federal income taxes, the interest payments (made indirectly by the private company) are considerably lower than would be required in an ordinary taxable financing. The type and size of facilities that may be financed by industrial development and pollution control bonds are limited by both federal and state law.

The act authorizes a county or city to designate an Industrial Facilities and Pollution Control Financing Authority as a governmental entity authorized to issue recovery zone facility bonds. It allows facilities that qualify as recovery zone property in connection with the issuance of recovery zone facility bonds to qualify as "special purpose projects" under the Act. Finally, it allows facilities used in the production of tangible or intangible personal property to qualify as "industrial projects" under the Act.

Conform North Carolina Capital Facilities Financing Act. – The act also makes changes similar to those made to the Industrial and Pollution Control Facilities Financing Act, to the North Carolina Capital Facilities Financing Act. It allows facilities used in the production of tangible or intangible personal property to qualify as "projects" under the North Carolina Capital Facilities Financing Act.

RESCIND ADVANCED PROPERTY TAX APPRAISAL.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-180	**HB 1530**	**Rep. Cole, Holloway, Burr, Starnes**

AN ACT TO VALIDATE THE SCHEDULE OF VALUES USED TO APPRAISE REAL PROPERTY FOR THE TAXABLE YEAR BEGINNING JULY 1, 2009, BY A COUNTY THAT ADOPTED A RESOLUTION TO POSTPONE A 2009 REAPPRAISAL BETWEEN JANUARY 1, 2009, AND JUNE 30, 2009.

OVERVIEW: This act validates a resolution adopted by a board of county commissioners between January 1, 2009, and June 30, 2009, to postpone a 2009 property tax reappraisal. The effect of the validated resolution is that the schedule of values adopted by the board of county commissioners and used to appraise real property in the county for its last reappraisal will remain the schedule of values for property tax appraisal purposes until the county reappraises real property in accordance with the statutory time schedule.[26]

FISCAL IMPACT: No General Fund impact.

EFFECTIVE DATE: This act became effective when it was signed into law by the Governor on June 26, 2009.

ANALYSIS: This past year's economic condition, in which the national median sales price for existing homes dropped by roughly 25%, the stock market began sliding, and North Carolina's unemployment rate increased, was an impetus for counties to postpone their 2009 property tax reappraisals.[27] In 2009, six counties voted to repeal or postpone their 2009 revaluations. Four of the counties that had advanced their property tax appraisals and had already conducted reappraisals for the 2009 taxable year, chose to postpone the 2009 appraisals after January 1, 2009.[28] In April, 2009, the North Carolina Attorney General issued an advisory memorandum confirming the earlier opinions of the Department of Revenue and the School of Government that North Carolina law does not permit a county to rescind a revaluation once the schedule of values becomes effective on January 1. The advisory memorandum pointed out that under North Carolina law a board of county commissioners must review and approve a schedule of values before January 1 of the year they are applied, and that the value of real property is determined as of January 1 of the year in which the valuation is fixed. Because the statutes do not expressly authorize a county to repeal a schedule of values once it takes effect, such authority may not be read into the statutes. A county must therefore proceed with the schedule of values approved by the county commissioners. The memorandum also emphasized that if a county were allowed to rescind previous approval of an advanced reappraisal and the new schedule of values at any time during the year, then the tax rate determined by the county might not meet its financial needs.[29]

The act validates the resolutions adopted by Caldwell, Stanley, and Rockingham Counties, as well as that of any other county, to repeal or postpone the 2009 revaluations so long as the boards of county commissioners voted to do so by June 30, 2009.

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[26] G.S. 105-286 requires counties to reappraise real property at least every eight years. The purpose of a reappraisal is to help a county fairly and equitably distribute the tax burden between the different classes of property. To accomplish this purpose, a county may voluntarily advance its reappraisal schedule to a shorter cycle by passing a resolution setting a different reappraisal cycle. A county that has advanced its reappraisal cycle may also pass a resolution to go back to a longer cycle, so long as the octennial requirement continues to be met.

[27] See Christopher B. McLaughlin, "The Revaluation Revolt of 2009", *Local Government Law Bulletin* No. 121 (September2009), available at www.sog.unc.edu/bulletins/lglb for a detailed discussion of the history of this legislation.

[28] Caldwell County passed a resolution on January 5, 2009, to delay its revaluation until 2011; Stanly County passed a resolution on January 20, 2009;Rockingham County passed its resolution on March 9, 2009; and Swain County abandoned its 2009 revaluation in June, 2009.

[29] A county must submit a tax rate to the governing board by June 1, and the rate must be approved by July 1. The tax rate, necessary to meet the financial needs of the county, is based upon the value of the taxable property.

TWO-THIRDS BONDS ACT OF 2008.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-209	**HB 1508**	**Rep. Owens, Goforth, Womble**

AN ACT TO MAKE TECHNICAL CORRECTIONS TO THE TWO-THIRDS BONDS ACT OF 2008 AND TO PROVIDE FOR THE ISSUANCE OF GENERAL OBLIGATION BONDS TO FINANCE THE COSTS OF THE BIOMEDICAL RESEARCH IMAGING CENTER.

OVERVIEW: This act modifies the Two-Thirds Bonds Act of 2008[30] in the following two ways:

- It changes the way the term 'biennium' is used for purposes of calculating the two-thirds bonds availability. The effect of this change is to extend the authorization for the sale of bonds for the Green Square Project into the 2009-2011 biennium.
- It adds as an authorized special indebtedness project the Biomedical Research Imaging Center at the University of North Carolina at Chapel Hill. The act authorizes the issuance of $223 million of non-voted general obligation bond indebtedness to finance the capital costs of this facility.

FISCAL IMPACT: No fiscal impact.

EFFECTIVE DATE: This act became effective when the Governor signed it into law on June 29, 2009.

ANALYSIS: Last year, the General Assembly, in its continuation budget, authorized the issuance of $107 million of non-voted general obligation bond indebtedness to finance the Green Square Project. General obligation bond indebtedness is secured by the faith and credit and taxing power of the State. As a general rule, general obligation bond indebtedness must be approved by the voters. However, under Article V, Section 3(f)[31] of the North Carolina Constitution, the State may issue non-voted general obligation bonds in an amount not to exceed two-thirds of the amount by which it reduced its outstanding general obligation debt in the preceding biennium. The term 'biennium' is not specifically defined in the Constitution. The Two-Thirds Bonds Act of 2008 used the term 'biennium' to refer to any consecutive two-year period. Specifically, it referred to the two-year period ending June 30, 2008. Based upon this formula, the State could have issued up to $125 million of non-voted general obligation bonds for fiscal year 2008-2009. No bonds have been issued under this authorization yet.

The current bond counsel for the State of North Carolina interprets the term 'biennium' as used in Article V, Section 3(f) of the North Carolina Constitution to refer to the traditional State biennium beginning on July 1 of odd-numbered years and ending on June 30 of the second

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[30] Section 27.9 of S.L. 2008-107, as amended by Section 2.7(c) and (d) of S.L. 2008-118.

[31] "**Sec. 3. Limitations upon the increase of State debt.**

(1) Authorized purposes; two-thirds limitation. The General Assembly shall have no power to contract debts secured by a pledge of the faith and credit of the State, unless approved by a majority of the qualified voters of the State who vote thereon, except for the following purposes:

…

(f) for any other lawful purpose, to the extent of two-thirds of the amount by which the State's outstanding indebtedness shall have been reduced during the next preceding biennium."

following year. Thus, two-thirds bonds may be issued during the biennium ending June 30, 2011 based on the amount of net debt reductions for the biennium ending June 30, 2009. This interpretation is consistent with the way the State applied the two-thirds provision for bonds authorized by legislation enacted in 1988 (S.L. 1987-1048) and in 1991 (S.L. 1991-760). With this change, the issuance of the two-thirds bonds authorized last session for the Green Square Project would be moved to the 2009-2011 biennium.

The Green Square Project consists of an office building for the North Carolina Department of Environment and Natural Resources, the construction of a Nature Research Center for the NC Museum of Natural Science, and an underground parking deck with 426 spaces. The Project also consists of another parking deck, authorized in S.L. 2006-231, which will house up to 900 spaces. The total cost of the Project, excluding the parking deck authorized in 2006, is $150 million. The General Assembly appropriated $25 million for the project last year. Parking receipts will service the debt for parking construction and the Friends of the Museum of Natural Science have committed $27.5 million towards the cost of the Nature Research Center and $15.5 million toward the cost of the exhibits.

This act also adds as a project to the Two-Thirds Bonds Act of 2008, the Biomedical Research Imaging Center at the University of North Carolina at Chapel Hill (BRIC). The act authorizes the issuance of $223 million of non-voted general obligation bond indebtedness to finance the capital costs of this facility.

Under the constitutional two-thirds limitation, the State may issue up to $486.8 million of non-voted general obligation bonds this coming biennium. Under the Debt Affordability Study, dated February 2009, the State's recommended debt affordability capacity for each of the next five years is $50.2 million. In conducting its analysis, the Treasurer's Office included anticipated debt of the Green Square Project. The addition of the BRIC project to the act would cause the State to exceed the recommended debt capacity. Therefore, the act also adjusts the indebtedness for several projects financed through special indebtedness to provide enough debt capacity, under the Debt Affordability Study, to add BRIC to the Two-Thirds Bonds Act of 2008.

EMS/FIRE DEPT. SALES TAX REFUND.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-233	**HB 511**	**Rep. Williams, Goforth, Lucas, E. Warren**

AN ACT TO REENACT THE SALES TAX REFUND FOR CERTAIN VOLUNTEER EMERGENCY RESPONSE PERSONNEL.

OVERVIEW: This act allows a volunteer fire department and a volunteer EMS squad that is exempt from income tax under the Internal Revenue Code (Code) a sales and use tax refund, regardless of how the nonprofit is organized.

FISCAL IMPACT: The act will reduce General Fund revenues by $2.4 million in fiscal year 2009-2010 and $2.5 million in fiscal year 2010-2011. The act will also reduce local revenues by $1.0 million in fiscal years 2009-2010 and approximately $1.0 million in each year thereafter. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2009 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The act is effective July 1, 2008, and applies to purchases made on or after that date. The retroactive effective date refers to the date that the 2008 clarifying legislation became effective. The change made by this bill effectively reinstates the semiannual sales and use tax refund for volunteer fire departments and voluntary EMS squads.

ANALYSIS: During the 2008 Session, the General Assembly clarified the types of nonprofits that may receive a semiannual refund of State and local sales and use taxes paid by the nonprofit on direct purchases of tangible personal property and services[32] for use in carrying on the work of the nonprofit entity. Prior to the clarification, the Department of Revenue had to determine whether an entity requesting a refund was a 'charitable institution.' To make its determination, the Department relied upon past determinations and court decisions. In May 2008, the North Carolina Court of Appeals appeared to expand what could be considered a 'charitable institution.'[33] The intent of the 2008 legislation was neither to expand nor limit the prior law's application but to clarify it.

The clarification provided a bright line test that used as its starting point nonprofits exempt from income tax under section 501(c)(3) of the Code. The clarification became effective July 1, 2008. After the passage of the legislation, some volunteer fire departments learned they no longer qualified for the sales and use tax refund because they were not organized as a section 501(c)(3) organization. Many of the volunteer fire departments organized prior to the mid-1970s organized as a section 501(c)(4) organization[34] because that is how, at the time, the IRS recommended they organize.

This act allows a volunteer fire department or a volunteer EMS squad that is exempt from income tax under the Code a sales and use tax refund, regardless of how the nonprofit is organized. A request for a refund for the first six months of a calendar year is due the following October 15, and a request for a refund for the second six months of a calendar year is due the following April 15. However, under G.S. 105-164.14(d), a refund is not barred unless it is applied for more than three years after its due date.

TAX INFO DISCLOSURE TO STATE TREASURER.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-283	**SB 691**	**Senator Dorsett**

AN ACT TO PERMIT DISCLOSURE OF CERTAIN TAX INFORMATION OF LOCAL GOVERNMENTS TO THE DEPARTMENT OF STATE TREASURER AND TO ENACT THE TREASURER'S GOVERNANCE AND TRANSPARENCY ACT OF 2009.

OVERVIEW: This act makes the following changes related to the authority of the State Treasurer:

- Permits the Department of Revenue to disclose certain tax information concerning local governments to the Treasurer's Office.

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[32] The refund does not apply to direct purchases of electricity, telecommunications service, or ancillary service.

[33] *The Lynnwood Foundation v. N.C. Department of Revenue*. 660 S.E.2d 611 (2008).

[34] Section 501(c)(4) refers to civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare.

- Increases the membership of the State Treasurer's Investment Advisory Committee from five to seven members by adding two public members and changes the experience requirements of the public members.
- Codifies the fiduciary standard to be applied to the Treasurer with respect to the discharge of his or her duties in connection with the retirement systems administered by the Treasurer's Office.
- Requires the Treasurer to make annual reports to the General Assembly on investments made under new grants of authority.[35]

FISCAL IMPACT: No fiscal impact.

EFFECTIVE DATE: This act became effective when the Governor signed it into law on July 10, 2009.

ANALYSIS: This act was requested by the Office of the State Treasurer and makes several changes related to the Treasurer's authority.

Disclosure of tax information. – The act creates a new exception in the tax secrecy statute by authorizing the Department of Revenue to release tax information to the Treasurer's Office concerning whether a local government has timely filed a withholding report, has charged a penalty, or has paid a penalty for failure to file the report. This information may be used by the Treasurer to determine compliance with the Local Government Finance Act.
Current law provides that the disclosure of tax information is prohibited unless the disclosure is for one of the purposes enumerated by statute. There are currently over 35 purposes for which disclosure is permitted. Individuals who disclose tax information in violation of the statute are guilty of a Class 1 misdemeanor. Public officials and employees who disclose tax information in violation of the statute are dismissed from office or employment and may not hold public office or public employment for five years after the violation.

Increased Investment Advisory Committee membership. – The State Treasurer is authorized to appoint an Investment Advisory Committee (Committee). Under prior law, the Committee consisted of five members: the State Treasurer, two members from the board of trustees of the Retirement Systems, and two public members. The public members were required to have experience in one or more of the following areas: investment management, real estate investment trusts, real estate development, venture capital investment, or absolute return strategies. The Committee has only advisory powers.

This act increases the membership of the Committee from five to seven members, with the two additional members to be appointed by the Treasurer as public members. The act also changes the experience requirements for the public members by removing the requirement for experience in real estate investment trusts and venture capital investments, and substituting experience in securities law.

Codification of fiduciary standard. – The State Treasurer is authorized to invest the assets of all the State-administered retirement systems. There are several limitations on the amount and types of investments that can be made with these funds. This act codifies the fiduciary standard applicable to the Treasurer with regard to the administration of the retirement systems. The standard was modeled on the Model Uniform Management of Public Employee Retirement Systems Act, which was approved by the National Conference of Commissioners on Uniform State Laws. Specifically, the Treasurer must discharge his or her duties as follows:

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[35] The last three bullets were originally the contents of Senate Bill 632.

- Solely in the interest of participants and beneficiaries.
- For the exclusive purpose of providing benefits and paying reasonable administrative expenses.
- With the care, skill, and caution under the circumstances that a prudent person who was familiar with the matters would use in a like situation.
- Impartially, taking into account the differing interests of participants and beneficiaries.
- Incurring only appropriate and reasonable costs.
- In accordance with a good-faith interpretation of the law governing the Retirement Systems.

The act also sets standards to be used by the Treasurer in investing and managing the assets of the retirement systems, including that the Treasurer:

- Must consider the following circumstances:
    - General economic conditions.
    - The possible effects of inflation or deflation.
    - The role of each investment in the overall portfolio.
    - The expected total return and the appreciation of capital.
    - Needs for liquidity, regular income, and preservation or appreciation of capital.
    - The adequacy of funding based on reasonable actuarial factors.
- Must diversify the investments unless the Treasurer determines it is clearly not prudent to do so.
- Must make reasonable efforts to verify relevant facts.
- May invest in any kind of real property which the State is authorized to acquire under Article 6 of Chapter 146 of the General Statutes.
- May consider other benefits created by an investment in addition to return on the investment, only if the investment would be prudent even without the collateral benefit.

The Treasurer's compliance with this standard must be determined based on the facts and circumstances at the time the decision was made, not using hindsight. In addition, the Treasurer's investment and management decisions must be evaluated in light of the portfolio as a whole and as part of an overall investment strategy.

Reporting requirement. – The act also provides that when the Treasurer is granted broadened investment authority by the General Assembly regarding certain funds, the Treasurer must report in detail to the General Assembly regarding the investments. The report must be made for four years after the new authority is granted, and include the return on those investments, earnings, changes to value, and gains and losses in the disposition of the investments. The funds are:

- The General Fund.
- The Teachers' and State Employees' Retirement System.
- The Consolidated Judicial Retirement System.
- The Firemen's and Rescue Workers' Pension Fund.
- The Local Government Employees' Retirement System.
- The Legislative Retirement System.

- The North Carolina National Guard Pension Fund.
- Any idle fund.

DEFER TAX ON BUILDERS' INVENTORY.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-308	**HB 852**	**Rep. Dickson, Brubaker, Holliman, Wainwright**

AN ACT TO DEFER A PORTION OF THE PROPERTY TAX DUE ON REAL PROPERTY HELD FOR SALE BY A BUILDER.

OVERVIEW: This act creates a property tax deferral program to defer for a maximum of three years the portion of taxes on an unoccupied, unsold residence attributable to the construction of the residence by a builder.

FISCAL IMPACT: This act is estimated to result in a deferral of local property tax revenues in the amount of $30-$35 million in FY 2010-11 and $7-$12 million in FY 2011-12. Minimal or positive impact in subsequent years as program sunsets and deferred taxes are paid.

EFFECTIVE DATE: This act is effective for taxes imposed for taxable years beginning on or after July 1, 2010, and is repealed for taxes imposed for taxable years beginning on or after July 1, 2013.

ANALYSIS: North Carolina currently has six property tax deferral programs: (i) historic district property held as future site of historic structures , (ii) the circuit breaker tax deferral program , (iii) nonprofit property held as future site of low or moderate income housing , (iv) present use value (PUV) property , (v) working waterfront property , and (vi) historic property. Uniform tax provisions for all deferral programs include the following:

- Taxes that are deferred under one of these programs become a lien on the property, which is extinguished when the taxes are paid.
- The deferred taxes are due and payable on the day the property loses its eligibility for deferral as a result of a disqualifying event.
- Interest accrues during the deferral period as of the date the taxes would have originally become due without the deferral program.
- Upon disqualification, the tax for a year in which a disqualifying event occurs is computed without the benefit of the deferral program.

This act adds a seventh property tax deferral program for an occupant-ready residence constructed[36] and owned by a general contractor for resale on a parcel of real property. The amount of property tax liability that can be deferred is the portion of tax that represents the increase in the property value resulting from the construction of the residence on the property. For example, if the land value of unimproved real estate was $100,000, and the value of the property, as improved by the construction of a residence, was $400,000, the builder must pay the property tax on the land value ($100,000) but may defer the property tax liability for the value of the improvement ($300,000).

[36] Construction activities limited to renovating, refinishing, rehabilitating, or remodeling do not qualify.

The deferred taxes are carried forward in the records of the county and, if applicable, the city in which the property is located until the occurrence of one of the following disqualifying events: (1) the builder transfers the residence; (2) the residence is occupied by the builder or another with the builder's consent; (3) five years from the time the improved property was first subject to being listed for taxation by the builder, or (4) three years from the date the improved property first received the property tax benefit provided by this deferral program. The uniform provisions for deferral programs apply to this inventory tax deferral program. Applications should be filed within the regular listing period and may be filed later if the board of equalization and review determines there is good cause for the lack of timely filing.

ENERGY SAVINGS CONTRACTS' CAP/PROGRAM ADMIN.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-375	**SB 304**	**Senator Clodfelter**

AN ACT TO INCREASE THE AMOUNT THE STATE MAY FINANCE UNDER GUARANTEED ENERGY SAVINGS CONTRACTS AND TO MODIFY THE REPORTING REQUIREMENTS.

OVERVIEW: This act increases the cap on guaranteed energy savings contracts and modifies the reporting requirements of the program.

FISCAL IMPACT: There is no net impact on General Fund revenues. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2009 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective when signed into law by the Governor on July 20, 2009.

ANALYSIS: State agencies and local governments have the authority to enter into financing contracts to finance the cost of energy conservation measures. Prior to this act, the aggregate principal amount payable by the State under these contracts was limited to $100 million. An energy conservation measure is a facility or meter alteration, training, or services that will provide anticipated energy savings with respect to a facility. The financing contracts are known as guaranteed energy savings contracts. Under the contract to implement energy conservation measures, all payments, except obligations on early termination, are to be made over time, and energy cost savings are guaranteed to exceed the cost of the contract.

The law provides that a guaranteed energy savings contract is not a pledge of the government's taxing power. The debt is secured by a lien on, or a security interest in, any part of the property with respect to which an energy conservation measure is undertaken and/or the land upon which the property is or will be located. It is anticipated that the energy savings will generate enough money to pay the debt service on the contract. This is a method of funding repair and renovation projects without impacting the State's debt capacity.

State agencies that enter into guaranteed energy savings contracts are required to report to the State Energy Office which, in turn, reports annually to the Joint Legislative Commission on Governmental Operations. State energy conservation measures are subject to inspection and compliance by the State Construction Office or the local building inspector. The cost of the evaluation of the contract by either an independent architect or engineer, or by the State Construction Office, and the costs of the necessary building inspections are included in the cost of the contract.

Before a guaranteed energy savings contract can be entered into, the Office of State Budget and Management must certify that resources are expected to be available to pay the amounts due under the contract. Next, the Council of State must approve the contract by resolution that sets out the maximum maturity and the maximum interest rates. The maximum maturity may not exceed 20 years. The State Treasurer also must approve the financing, finding that the amount to be borrowed is adequate and not excessive, that it will not require an excessive increase in any State revenues to provide for repayment, and that the special indebtedness can be incurred or issued on terms favorable to the State.

This act increases the limit on the contracts from $100 million to $500 million, and clarifies that the limit is a revolving limit based on the amount of contracts at any given time rather than a limit on the aggregate amount of all savings contracts entered into. The act requires a qualified provider to conduct a life-cycle cost analysis of each conservation measure in a final proposal. A life-cycle cost analysis considers certain costs of owning and using property over its economic life, including the initial costs, system repair and replacement costs, maintenance costs, operating costs, and salvage value. The act also requires local governments that enter into energy savings contracts to report the contracts and the terms of the contracts to the State Energy Office. Previously, local governments that entered into energy savings contracts were required to report the contracts to the Local Government Commission.

JDIG TECHNICAL MODIFICATIONS.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-394	**HB 1516**	**Rep. Crawford, Dickson, Gibson**

AN ACT TO MAKE CERTAIN MODIFICATIONS TO AND EXTEND THE SUNSET OF THE JOB DEVELOPMENT INVESTMENT GRANT PROGRAM.

OVERVIEW: This act makes clarifying and technical changes to the Jobs Development Investment Grant program and extends the sunset of the program from 2010 to 2016.

FISCAL IMPACT: No impact.

EFFECTIVE DATE: This act became effective when the Governor signed it into law on July 31, 2009.

ANALYSIS: In 2002, the General Assembly created a new economic development tool for new and expanding businesses in North Carolina, the Job Development Investment Grant (JDIG) Program. JDIG is used to attract businesses to the State by allowing a five-member Economic Investment Committee[37] to award grants to businesses. The grants may be awarded over as many as 12 years, and the amounts of the grants are based on income tax withholdings from new jobs created by the businesses. The Committee may enter into no more than 25 agreements per calendar year and may commit no more than $15 million in any fiscal year under all agreements entered into during a single calendar year. When the General Assembly created the program, it imposed a two-year sunset on the authority of the Committee to enter into new grant agreements. The General Assembly has voted to extend this sunset three times since its

[37] The members of the Committee are the Secretary of Commerce, the Secretary of Revenue, The Director of the Office of State Budget and Management, and two public members appointed by the General Assembly, one upon the recommendation of the President Pro Tempore of the Senate and the other upon the recommendation of the Speaker of the House of Representatives. G.S. 143B-437.54.

enactment.[38] This act extends the program a fourth time, from January 1, 2010 to January 1, 2016.

The act also makes the following clarifying and technical changes to the program, upon the recommendation of the Department of Commerce.

- Section 1 removes the reference to 'negotiated' agreements because the form of the basic agreement is standard for all grantees. The term 'negotiated' has led some grantees to believe they may negotiate the terms required by the State.
- The act clarifies that the JDIG program awards grants, and that the program may enter into agreements with businesses to provide grants.
- Section 1 removes language that refers to the cap on annual grants for the year 2006.
- Section 2 clarifies that a business may apply for grants that include performance by related members of the business. The purpose of this change is to make it clear that the grantee is not the legal representative of the related member and that the related member has no legal right to grant payments. Current law provides that a business may not include performance by related members in its application for a grant unless the related members assign to the business any claim of right the related members may have to apply for grants individually.
- Section 2 changes the annual reporting requirements of the JDIG program as follows:
    - The report must include the annual maximum State liability under each grant awarded as well as the maximum total lifetime State liability under the grant.
    - The report may list the wage levels of jobs created by projects that received grants in increments of $10,000 as opposed to $5,000.
    - The report must identify any changes in criteria developed by the Economic Investment Committee to implement the program.
    - The report must indicate separately the number of awards made to new businesses and those made to existing, expanding businesses.
- Sections 3 and 5 change the method for reducing grants whenever a grantee defaults upon one or more of the provisions in the agreement. Previously, the Economic Investment Committee had to must formally approve an amendment to the grant agreement to implement the grant reduction. Under the act, the Committee and its staff may reduce the amount or term of grant if a grantee fails to comply with the terms of the agreement. A grant agreement must include provisions providing the Committee with this authority. It also provides for a reduced payment due to default in the payment for the year in which the default occurred, rather than the following year.
- Section 4 clarifies that the grantees must provide annual reports showing withholding as well as identifying positions created during the year that remained filled at the end of the year.

[38] S. L. 2004-124, S.L. 2005-241, and S.L. 2006-168.

CONTINUE SCHOOL CONSTRUCTION FUNDING.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-395	**HB 311**	**Rep. Yongue, Glazier, Johnson, Wainwright**

AN ACT TO CONTINUE THE CONSTRUCTION FUNDING OF SCHOOLS THROUGH THE FIRST AND THE SECOND ONE-HALF CENT SALES AND USE TAXES.

OVERVIEW: This act makes permanent the designation of a certain percentage of local sales and use taxes for public school capital outlay purposes or related debt retirement by eliminating the sunsets on those requirements.

FISCAL IMPACT: This act has no impact on General Fund revenues. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2009 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act is effective January 1, 2010, and applies to sales made on or after that date.

ANALYSIS: A percentage of the first ½ cent and second ½ cent sales and use tax levied by counties must be used for public school capital outlays. Under both the first ½ cent and second ½ cent sales and use tax, the amount designated for public school capital outlay may be used to retire indebtedness incurred for public school capital outlay. However, if a county can demonstrate that it does not need the earmarked revenue to meet its public school capital needs, it may petition the Local Government Commission to authorize it to use the money for any public purposes. In making its decision, the Commission must consider not only the public school capital needs but also the other capital needs of the county.

First ½ Percent Sales and Use Tax. – Article 40 of Chapter 105 of the General Statutes provides counties that levy a one percent (1%) sales and use tax the authority to levy an additional one-half percent (1/2%) sales and use tax. For the first five years of the tax, 40% of the revenue must be used for public school capital outlay; for the next 23 years of the tax, 30% of the revenue must be used for public school capital outlay. This act amends G.S. 105-487 to require that after the first five years that the first one-half percent (1/2%) sales tax is in effect, 30% of the revenue must always be used for public school capital outlay or indebtedness.

Second ½ Percent Sales and Use Tax. – Article 42 of Chapter 105 provides counties that levy the one percent (1%) sales tax and the additional first one-half percent (1/2%) sales and use tax the authority to levy a second one-half percent (1/2%) sales and use tax. For the first 25 years of the tax, 60% of the revenue must be used for public school capital outlay, unless the amount allocated to the county under the first one-half percent (1/2%) is greater than the amount allocated under the second one-half percent (1/2%) sales tax, the difference between the two amounts. This act amends G.S. 105-502 to require that 60% of the revenue from the second one-half percent (1/2%) sales tax, as designated in that section, must always be used for public school outlay purposes or to retire indebtedness incurred for that purpose during the five years before the indebtedness took effect.

SALES TAX: RELIANCE ON WRITTEN ADVICE BY DOR.

Session Law	*Bill #*	*Sponsor*

S.L. 2009-413	SB 909	Senator Clodfelter

AN ACT EXTINGUISHING THE LIABILITY OF RETAILERS FOR SALES TAX OVERCOLLECTIONS MADE IN RELIANCE ON WRITTEN ADVICE OF THE SECRETARY OF REVENUE.

OVERVIEW: This act provides that if a retailer collects sales tax from a customer in excess of the amount that should have been collected, based on specific written advice it received from the Secretary of Revenue, the retailer is not liable to the customer for the overcollected amount. The act also clarifies that there is no change to the current requirement that a retailer must issue a refund to the customer prior to the retailer obtaining a refund from the Department.

FISCAL IMPACT: No fiscal impact.

EFFECTIVE DATE: This act became effective when the Governor signed it into law on August 5, 2009.

ANALYSIS: This act provides that a seller is not liable to a purchaser if the seller collected and remitted sales and use tax in accordance with written advice it received from the Department.

All sales taxes, including over-collections, must be remitted to the Department. In the case of an overcollection, a purchaser's first course of remedy is to seek a refund from the seller who, in turn, may obtain a refund from the Department. A cause of action against the seller does not accrue until a purchaser has provided written notice to a seller, and the seller has had sixty days to respond. If the seller issues a refund or credit to the purchaser, the seller may then apply to the Department for the amount of the refund or credit. A seller is not entitled to a refund or credit unless the purchaser has been refunded or received a credit for the amount of tax erroneously charged.

A taxpayer may request specific advice from the Department. If the Department furnishes erroneous advice and the taxpayer reasonably relies on that advice, the taxpayer is not liable to the Department for any penalty or additional assessment attributable to the erroneous advice to the extent the following conditions are satisfied:

- The advice was reasonably relied upon by the taxpayer.
- The penalty or additional assessment did not result from the taxpayer's failure to provide adequate or accurate information.
- The Department provided the advice in writing or the Department's records establish that the Department provided erroneous verbal advice.

Current law already provides that a taxpayer (in this case, the seller) is not liable to the Department for any penalty or additional assessment if the advice it received from the Department was wrong. Under this act, a seller is immunized from liability with respect to a purchaser from whom it overcollected sales and use tax based on advice the seller relied upon from the Department.

FRANCHISE TAX-OVERBILLING OUT OF CAPITAL BASE.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-422	**SB 367**	**Senator Jenkins**

AN ACT TO REMOVE BILLINGS IN EXCESS OF COSTS FROM THE FRANCHISE TAX CAPITAL BASE FOR TAXPAYERS USING THE PERCENTAGE OF COMPLETION METHOD OF REVENUE RECOGNITION.

OVERVIEW: This act excludes from a corporation's franchise tax base all billings in excess of costs, effective for taxable years beginning on or after January 1, 2010.

FISCAL IMPACT: This act has the potential to impact General Fund revenues. However, according to the Department of Revenue a specific determination was not possible. Currently, the account is either incorrectly included in the liabilities total as definite and accrued, or properly excluded from this amount. Because the exclusion is not specifically reported on the return, it is not possible to quantify the number of taxpayers in compliance with current law or not in compliance. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2009 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The act becomes effective for taxable years beginning on or after January 1, 2010.

ANALYSIS: This act exempts billings in excess of costs from surplus and undivided profits, thus excluding them from the franchise tax capital base.

The State imposes a franchise tax on C-corporations and S-corporations. The tax rate is $1.50 per $1,000[39] and is applied to a company's capital stock, surplus, and undivided profits.[40] The term "surplus" for franchise tax purposes has a broader and more inclusive meaning than the generally accepted accounting definition. G.S. 105-122(b) provides that surplus and undivided profits includes all liabilities, reserves, and deferred credits unless those items are specifically exempt. One of the exemptions from surplus and undivided profits is "definite and accrued legal liabilities." The Department of Revenue defines a definite and accrued legal liability as one that meets both of the following conditions:

- The liability is definite in amount, meaning it is exactly determined and not merely accurately estimated.
- The liability will be incurred before the end of the taxable year.

Generally accepted accounting principles require that revenue be recorded in the period it is earned regardless of when it is billed or when cash is received. In long-term construction contracts, there is often a mismatch between actual billed revenue and earned revenue. Sometimes elements of a contract are billed in advance and sometimes they are delayed. The accounting solution to this problem is the percentage of completion method of revenue recognition. Under this method of accounting, where the costs can be reasonably estimated, revenue is recognized as production takes place. This method of accounting may result in "billings in excess of costs" or "cost in excess of billings." Billings in excess of costs is a balance sheet liability because it represents unearned income. Cost in excess of billings is a balance sheet asset. For purposes of the State's franchise tax, the balance sheet liability of "billings in excess of costs" is not considered a definite and accrued legal liability because it is based on estimates; therefore, it is included in a corporation's capital base.

The construction industry sought to change this interpretation because it resulted in contractors having to pay taxes on liabilities and for revenue they had not actually received. The act

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[39] The minimum tax is $35.

[40] A corporation's capital base may not be less than 55% of the appraised value of tangible property in NC, nor less than its actual investment in tangible property in the State.

incorporates the industry position by providing that billings in excess of costs that are determinable using the percentage of completion principles are exempted from surplus and divided profits, and therefore, excluded from the franchise tax base.

REV LAWS TECH, CLARIFYING, & ADMIN. CHANGES.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-445	**SB 509**	**Senator Hartsell**

AN ACT TO MAKE TECHNICAL, CLARIFYING, AND ADMINISTRATIVE CHANGES TO THE TAX AND RELATED LAWS.

OVERVIEW: This act makes technical, clarifying, and administrative changes to the following taxes and related laws: privilege license, income, excise and insurance taxes; sales and use taxes and highway use taxes; property taxes; occupancy taxes; and motor fuel taxes.

FISCAL IMPACT: No impact. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2009 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: Except as otherwise specified, this act became effective when signed into law by the Governor on August 7. 2009.

ANALYSIS:

Section	Explanation
Privilege License, Income, Excise, and Insurance Tax Changes	
1	Clarifies the privilege license tax on home inspectors applies to an individual licensed under the Home Inspector Licensure Act so that associate home inspectors will be taxed similarly. S.L. 2008-206 imposed an annual State privilege license tax of $50 on a licensed home inspector but it failed to mention associate home inspectors. Without this change, an associate home inspector would be subject to local privilege license tax in each city that levies the tax.[41]
2	Moves the definitions from subsection (b) to a newly created subsection (b1). The current subsection (b) contains two different subdivision lists. This change puts the defined terms, listed by subdivisions, into a new subsection.
3	Clarifies that a recycling facility[42] that is eligible for the tax credit for investing in large or major recycling facility is not also eligible for the Article 3J tax credit for investing in business property. This section becomes for taxable years beginning on or after January 1, 2007, the year the Article 3J tax credits became effective.

[41] S.L. 2009-509 sunset the associate home inspector license. That legislation provides that the Home Inspector Licensure Board may not accept applications for associate home inspector licensees after April 1, 2011, and it may not renew an associate home inspector license after October 1, 2013.
[42] The General Assembly enacted the credit as a tax incentive for Nucor in 1985.

4	Changes the term 'nonbusiness activities' to 'activities producing nonapportionable income', which is a defined term in the statute that sets out the manner in which corporations must allocate and apportion their income to North Carolina for income tax purposes. In 2002, the terms 'business income' and 'nonbusiness income' were replaced by apportionable and nonapportionable. This subsection was missed when those changes were made.
5	Clarifies that a corporate taxpayer may not use an alternative apportionment method unless it receives a written decision from the Secretary authorizing it to do so. A return that is not filed in accordance with the statutes is an improper return. This section specifically states that return prepared using an alternative apportionment formula without the permission of the Secretary is an unlawful return.
6	Corrects an effective date relating to changes made to the statute designating who may sign an income tax return. These changes were originally part of the major rewrite of the tax appeals procedure in 2007 (SB 242).
7	Repeals an unnecessary statute in the corporate and personal income tax laws. The Department of Revenue does not ask taxpayers to file a 'supplemental' return. A taxpayer files either an original return or an amended return. If the Department determines additional tax is due, it proposes an assessment.
8	Clarifies the reporting requirements for the film industry credit. The term 'claimed' may have several different meanings. The Department of Revenue requested clarity as to the meaning of the term.
9	Clarifies the application of the dollar cap amounts under the qualified business investment credit and the credit for certain real property donations in light of the 2009 Court of Appeals decision in the *North Carolina Department of Revenue v. Hudson* case. In that case, the court held that the statutory cap of $50,000 limits the amount a taxpayer may claim in a single tax year and allowed the taxpayer to carry forward amounts in excess of the cap. The change makes clear that an individual may only carry forward unused amounts of the credit up to the cap rather than being able to carry forward amounts in excess of the cap.
10	Changes the date by which the State Treasurer must make a transfer from the General Fund to the North Carolina Health Insurance Risk Pool Fund. The statute provided that *within 75 days after the end of each fiscal year*, the Treasurer must transfer to the Fund an amount equal to the growth in net revenue from the gross premiums tax on insurance companies. Insurance tax returns are due by March 15. Insurance companies are also required to prepay their tax in installments. The first installment of the fiscal year is due by October 15. Therefore, until those installments are remitted, little or no funds are available for transfer. This section changes the date from within 75 days after the end of the fiscal year, or September 14, to November 1, as recommended by the Department of Revenue.

Sales and Use Tax and Highway Use Tax Changes	
11	Updates the reference to the Streamlined Agreement from June 23, 2007 to May 12, 2009. North Carolina does not need to amend its sales and use tax laws to conform to the changes made in the Agreement since June 23, 2007. A copy of the Agreement, as well as a document summarizing the changes made to the Agreement since June 23, 2007, may be found on the Streamlined Sales Tax Project's website: www.streamlinedsalestax.org
12	Makes two conforming changes to the general sales tax sourcing principles. It provides that direct mail is sourced to the location where the property is delivered, and if that is unknown, it is sourced to the location from which the direct mail was shipped. This change ensures compliance with the Streamlined Agreement. This section also codifies the long-standing sourcing method used for florist wire sales: the sale is sourced to the business location of the florist that takes the order for the sale.
13	Reorganizes the statutory subsection without making any substantive changes.
14	Replaces the word 'energy' with the word 'electricity' for consistency. This term appears in the statute enacted last year authorizing a sales tax refund for materials used to build a facility that manufactures solar electricity generating materials. This section is effective July 1, 2008, the effective date of the original provision.
15	Provides a new distribution methodology for the allocation of sales tax collected o modular homes to local governments. The methodology currently references the distribution under the third ½ cent local sales and use tax; but this tax is repealed effective October 1, 2009. A 2.5% State sales tax applies to the sale of a modular home. Twenty percent of the tax collected is distributed to the counties. This amounts to approximately $1 million annually. This section provides that 20% of the sales tax collected on modular homes will be allocated to the counties on a per capita basis, and distributed to the county and its municipalities as provided in the first ½ cent local sales tax.
16	Repeals an unnecessary highway use tax exemption. A transfer of a motor vehicle to a handicapped person from the Department of Health and Human Services after the vehicle is equipped by the Department for use by the handicapped is exempt from highway use tax. The exemption is not needed because the Department never takes title to the vehicle.
17	Corrects two incorrect statutory references.
18	Clarifies how a bundled transaction that includes food is taxed under the local option ¼ cent county sales tax article. See *GS 105-164.4D*.
19	Simplifies the Mecklenburg local sales tax in Chapter 1096 of the 1967 Session Laws without making any substantive changes. Currently, the administration of the sales and use tax under the Mecklenburg local act and Article 39 of Chapter 105 are the same with the exception of the distribution formula. Under the local act, proceeds are divided between the county and the cities on an ad valorem basis; Article 39 gives counties a choice between ad valorem and per capita.

Property Tax Changes	
20	Reinserts the word 'shares', which was inadvertently deleted from the definition of 'corporation' when changes were made in 2008 to the property tax homestead circuit breaker.
21	Modernizes the language.
22.(a)	Clarifies that the homestead exclusion applies uniformly to a husband and wife, regardless of how they hold title to the property.
22.(b)	Makes the following clarifying and technical changes to the homestead circuit breaker: • Clarifies that property owned by a qualifying owner must have been the owner's permanent residence for at least five consecutive years but that the owner's five-year occupancy does not have to be consecutive. • Clarifies that the occupancy and ownership requirement refers to 'length' of occupancy and ownership. • Clarifies that the homestead circuit breaker applies uniformly to a husband and wife, regardless of how they hold title to the property. • Removes an unnecessary word. • Clarifies that a person may defer the portion of the principal amount of tax that is imposed for the current tax year on the residence and exceeds the percentage of the qualifying owner's income. • Clarifies that only the deferred taxes for the last three years prior to the disqualifying event become due and payable. • Clarifies that notice of the sum of deferred taxes and interest that are due and payable must be sent annually to the mailing address of the residence subject to the circuit breaker benefit as opposed to mailing notice to each owner of the property.
22.(c)	Makes the following clarifying changes to the disabled veteran homestead exclusion: • Replaces the definition of 'owner' with a definition for 'qualifying owner'. • Provides that a disabled veteran must have 'separated' instead of 'been discharged' from a branch of the Armed Forces to reflect more clearly the language used by the Armed Forces. • Provides that the exclusion applies to a disabled veteran whose separation was also under honorable conditions. Prior law applied the exclusion only if the separation was honorable. • Clarifies that the surviving spouse of a disabled veteran is eligible for the exclusion as long as the spouse does not remarry. • Provides that the surviving spouse may also qualify for the exclusion if the Veterans Administration certifies that the veteran's death was the result of a service-connected condition. This new language would

	apply where the veteran died while on active duty and the death was the result of a service-connected condition or where the veteran died after discharge due to a service connected condition that did not rise to the level of total and permanent disability. • Clarifies that the exclusion is available to a disabled veteran who 'received' instead of 'receives' federal benefits to adapt the veteran's housing, since these benefits are generally a one-time payment. • Clarifies that the exclusion applies uniformly to a husband and wife, regardless of how they hold title to the property.
22.(d)	Section 22 of the act is effective for taxes imposed for taxable years beginning on or after July 1, 2009
23.(a)	Repeals a reference to an incorrect effective date for the wildlife conservation land tax benefit.
23.(b)	Repeals the provision in the working waterfront statute regarding application procedures because there is a general statute governing application procedures for property tax exemptions or exclusions.
23.(c)	Adds drug samples to the list of exempt property not requiring an application, effective for taxes imposed for taxable years beginning on or after July 1, 2008. Adds solar energy electric systems to the list of property excluded from taxation that must file a single application, effective for taxes imposed for taxable years beginning on or after July 1, 2008.
23.(d)	Adds working waterfront property to the list of property classified for taxation at reduced valuation that must file a single application, effective for taxes imposed for taxable years beginning on or after July 1, 2009.
23.(e)	Adds wildlife conservation to the list of property classified for taxation at reduced valuation that must file a single application, effective for taxes imposed for taxable years beginning on or after July 1, 2010.
23.(f)	Sets out the effective dates for section 23, as noted in the subsections above.
24.(a)	Makes the following changes to the combined motor vehicle registration and property tax system which provides for the collection of vehicle property taxes with the issuance and renewal of vehicle registrations. Adds the following definitions to G.S. 105-330: 'registered classified motor vehicle', 'unregistered classified motor vehicle', and 'registration fees'. • Amends G.S. 105-330.1 to add the following to the list of motor vehicles that are exempt from classification under the combined system: motor vehicles issued permanent registration plates and self-propelled property-carrying vehicles issued three-month registration plates at the farmer rate. • Amends G.S. 105-330.2(a) and (a1) to clarify the period in which the value of a classified motor vehicle is determined so that the date of valuation will continue to be January 1. If the value cannot be determined on January 1, then the value will be the most currently available January 1 retail value of the vehicle. Subsection (a) also clarifies that the situs of a vehicle is determined on the date

	registration is applied for or renewed and may not be changed until the next registration date. • Amends G.S. 105-330.2(b) to add language that the initial appraised value of a vehicle purchased from a dealer is the sales price, including all accessories attached to the vehicle. • Amends G.S. 105-330.2(b1) to clarify the right to appeal the appraised value or taxability of a vehicle as follows: require that the right to appeal must be set out in the combined tax and registration notice or the tax receipt, and require that the lessee of a motor vehicle be given the right to appeal the value if the lessee is required to pay the tax on the vehicle under the terms of the lease. • Amends G.S. 105-330.3 to add subsection (d) setting out the penalty for willfully attempting or aiding or abetting any person to evade or defeat the taxes imposed under the combined system, and to make technical and stylistic changes. • Amends G.S. 105-330.4 as follows: subsection (a) removes unnecessary language and adds language clarifying when taxes are due on an unregistered classified motor vehicle, a classified motor vehicle registered under the staggered system, a classified motor vehicle registered under the annual system, and a classified motor vehicle that has a temporary registration plate or a limited registration plate; subsection (b) deletes unnecessary language; subsection (c) clarifies that the enforcement remedies for unpaid property taxes apply only to unpaid taxes on an unregistered classified motor vehicle. • Amends G.S. 105-330.5 by deleting unnecessary language, making stylistic changes, and adding the following clarifications: subsection (a) authorizes the Department to select a third party contractor to prepare and mail combined tax and registration notices, clarifies the contents of the combined notice, clarifies that if there is a pre-payment of taxes then the tax rate will be the rate in effect on the date the taxes are computed, and provides that the combined notice serves as the registration certificate for a vehicle issued a limited registration plate; subsection (b) clarifies that a lessee of a vehicle would receive a combined notice since the definition of 'owner' includes the lessee of a vehicle; subsection (d) clarifies that taxes on motor vehicles be included in the tax levy for the fiscal year in which the taxes are collected; and new subsection (e) describes the method for handling small underpayments and overpayments of taxes. • Amends G.S. 105-330.8 to add the following property tax statutes to the statutes that do not apply to the combined motor vehicle registration and property tax system: G.S. 105-321(f) (governing the collection of minimal taxes charged) and G.S. 105-360

	(governing the due date of property taxes, interest for nonpayment of taxes, and discounts for prepayment of taxes). • Amends G.S. 105-330.9 to add subdivision headings. Amends G.S. 105-330.11 by making stylistic changes. Except for changes to G.S. 105-330.9 and G.S. 1-5-330.11, the above changes become effective July 1, 2011, and apply to combined tax and registration notice issued on or after that date, 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.
24.(b)	Amends G.S. 20-79.1A to clarify issuance of a limited registration plate as follows: (1) the limited registration plate is issuable to a person who applies for a title to a motor vehicle and a registration plate if the person submits the title and registration fees but does not submit municipal corporation property taxes due on the vehicle; (2) if the municipal corporation property taxes are paid, then the person receives an annual registration plate; (3) a limited registration plate may only be used on the vehicle for which issued and if lost or stolen, a replacement plate must be received and attached to the vehicle before it may be driven. Subsection (b) becomes effective July 1, 2011, and applies to combined tax and registration notices issued on or after that date, 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.
24.(b1)	Amends G.S. 20-63(h) to clarify that a contract agent with the Division of Motor Vehicles receives compensation for issuing a vehicle registration card only when property taxes on the vehicle are not paid at the same time.
24.(c)	Sets out the effective dates for section 24 of this act.
25	Moves the effective date of the combined motor vehicle registration and property tax system from July 1, 2010 to July 1 2011, and clarifies that it applies to combined tax and registration notices issued on or after that date, or when the DMV and the Department of Revenue certify that the system is in operation, whichever occurs first.
26	Amends G.S. 105-361(a) to make stylistic changes and to clarify that the amount of taxes that a tax collector must report on a tax certificate includes any deferred taxes that would become due if a disqualifying event occurs.
27	Makes the following clarifying changes to G.S. 160A-215.2 (Heavy equipment gross receipts tax in lieu of property tax): • Changes the word 'resolution' to 'ordinance' to reflect that cities adopt ordinances while counties adopt resolutions. • Provides that a tax levied prior to the effective date of this act remains valid and in effect until amended or repealed, regardless of whether the city called the action a resolution or an ordinance. • Removes the reference to 'city finance officer', because the city may contract with the county to collect the gross receipts tax.
Occupancy Tax Changes	

28	Adds a Session Law reference that was inadvertently omitted when the Cherokee County local occupancy tax act was amended last year. In 2007, a number of local occupancy tax local acts were amended to change the due date for remitting occupancy tax proceeds and filing returns from the 15th to the 20th of the month to conform to current sales tax statutes. The Cherokee County local occupancy tax act was one of the acts so amended. However, when the rest of the local act was amended in 2008, the 2007 change was not incorporated. To make this technical change, the entire local act must be set out under drafting convention. However, no substantive change is being made.
29	Corrects an incorrect Session Law reference.
30	Adds to S.L. 2005-68, a Session Law reference to the 2007 act referenced above that made changes to a number of local occupancy tax acts related to the due date of the tax and return. S.L. 2005-68 is the act that authorized the additional occupancy tax to finance the NASCAR Hall of Fame Museum.
Motor Fuel Tax Changes	
31	Provides the Secretary with the ability to mandate electronic filing of motor carrier tax returns. The Secretary may currently mandate electronic filing of motor fuel tax returns. The Department developed an online filing system for motor carrier returns six years ago. To date, voluntary compliance is around 19%. This section becomes effective January 1, 2010.
32	Inserts a missing word.
33	Provides an exception to the requirement that a distributor, importer, or motor fuel transporter must obtain a bond or irrevocable letter of credit when the person is supplying motor fuel into the State because the market for motor fuel has been disrupted and emergency supplies are needed, as identified by an executive order of the Governor. The bonding requirement became an issue during the recent motor fuel supply shortages in the western part of the State.
34	Specifies that the tax on fuel grade ethanol is payable by the refiner or fuel alcohol provider. The difference between a refiner and a fuel alcohol provider is the amount of fuel the person produces. A refiner is a person who produces an average of more than 500,000 gallons a month; a person who produces less than this amount is a fuel alcohol provider. This section changes the law enacted last year in S.L. 2008-134 that specified when fuel grade ethanol was subject to tax. Effective January 1, 2009, the fuel is taxable when it was removed from a terminal or when it is produced in the State or imported to the State and not delivered to a terminal. However, the Department has had difficulty administering this provision. Ethanol is primarily shipped by railroad tank car and once imported into the State the ethanol may not be off-loaded for weeks. Since the tax is imposed upon importation, this delay in off-loading creates a loop-hole for filers. This section provides that the ethanol produced in this State is taxable when it is removed from the storage facility at the production location; ethanol produced outside the State is taxable when it is imported to the State. Prior to 2009, fuel grade ethanol was first subject to tax when it was blended. This section becomes effective January 1, 2010.
35	Changes the hold harmless refund from a quarterly one the Department calculates and administers to a monthly one the taxpayer requests. This

	section becomes effective January 1, 2010, and applies to motor fuel purchased on or after that date.
36	Requires a shipping document to transport fuel grade ethanol since the ethanol is now subject to tax before it is blended. This section accomplishes this change by expanding the statute to include refiners and fuel alcohol providers. This section also recognizes that the content of a shipping document issued for motor fuel transported by railroad tank car differs from a one issued for fuel transported by transport trucks. This section becomes effective January 1, 2010.
37	Corrects a misspelled word.
38	Conforms the tax exemptions for alternative fuel to the tax exemptions for motor fuel.
Other Changes	
39	Amends the tax secrecy provisions to prohibits the disclosure of standards used or to be used for the selection of returns for examination and the disclosure of data used for determining those standards. The Department of Revenue requested this provision.
40	Corrects a statutory reference. The statute cited was repealed in 2006.
41	Repeals the session law that created the Economic Development Reserve and its exemption from rule-making. The Reserve had a one-time appropriation. The money in the fund has been drawn down. The Reserve has served its intended purpose and is no longer necessary.
42	Corrects the prefatory language of Section 28.19.(a) of S.L. 2008-107.
43	Corrects the prefatory language of Section 28.25.(c) of S.L. 2008-107.
44	Corrects an incorrect statutory reference.
45	Corrects the effective date sections in S.L. 2008-146 to refer to 'Parts' rather than 'sections'.
46	Corrects the effective date section in Section 5.4 of S.L. 2008-204 to refer to 'Part' rather than 'section'.

APPROPRIATIONS ACT OF 2009.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-451, as amended by S.L. 2009-575	**SB 202**	**Senator Garrou**

AN ACT TO MAKE BASE BUDGET APPROPRIATIONS FOR CURRENT OPERATIONS OF STATE DEPARTMENTS, INSTITUTIONS, AND AGENCIES, AND FOR OTHER PURPOSES.

OVERVIEW: This act updates the reference to the Internal Revenue Code to May 1, 2009, but decouples from the bonus depreciation provision and the new additional standard deductions for real property taxes and motor vehicle sales taxes. The act adopts the proposal recommended by the Revenue Laws Study Committee to apply the State and local general rate of sales and use tax to audio works (music and ringtones), audiovisual works (movies), books, and computer software that are delivered or accessed electronically to the extent those items would be taxable if sold in a tangible medium and to revise the mail order sale statute to specifically set out certain circumstances that constitute soliciting business in this State for

purposes of requiring a remote retailer to collect sales tax. Lastly, the act generates revenue required to balance the 2009-2010 biennium budget by making the following tax law changes:

- Income tax surtax on individuals whose North Carolina taxable income is greater than $100,000[43] and on corporations, for taxable years 2009 and 2010.
- A State sales tax increase of 1%, effective September 1, 2009, until July 1, 2011.
- An increase in the excise taxes on beer, wine, liquor, cigarettes, and other tobacco products. All of the increased tax revenue is distributable to the State.
- Retention by the State of a portion of the distribution of the excise tax on beer and wine that would otherwise be distributable to counties and cities for one year.

The act also authorizes the Finance Committees of the Senate and the House of Representatives to meet during the interim to study and recommend legislation to reform North Carolina's sales and income tax structure in order to broaden the tax base and lower the State's tax rates.

FISCAL IMPACT: The act increases General Fund revenues by approximately $990 million for fiscal year 2009-2010 and $1.3 billion for fiscal year 2010-2011. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2009 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: With the exception of the provision related to the real property tax deduction for non-itemizers, which is effective for taxable years beginning on or after January 1, 2008, the remaining IRC conformity provisions are effective for taxable years beginning on or after January 1, 2009. The revision of the statutes relating to remote retailers became effective when signed into law by the Governor on August 7, 2009. The expansion of the sales tax base to digital products becomes effective January 1, 2010. The increase in the excise taxes on beer, wine, liquor, and tobacco products became effective September 1, 2009. The income tax surtax is effective for taxable years 2009 and 2010. The increase in the State sales tax rate became effective September 1, 2009, and expires July 1, 2011.

ANALYSIS: Part XXVIIA of the Current Operations and Capital Improvements Appropriations Act of 2009 made the following tax law changes:

Corporate and Individual Income Tax Surtax. – Section 27A.1 increases General Fund revenues by approximately $196 million in fiscal year 2009-2010 and $202 million in fiscal year 2010-2011, by imposing a temporary income tax surtax on corporate taxpayers and individual taxpayers whose North Carolina taxable income exceeds $100,000. The corporate income tax surtax is equal to 3% of the tax payable by the taxpayer for the taxable year. The individual income tax surtax is also equal to a percentage of the tax payable by the taxpayer.[44] The percentage amount varies depending upon the taxpayer's North Carolina taxable income[45] and the taxpayer's filing status. For married filing jointly, the surtax percentage is zero for taxable incomes up to $100,000; it is 2% for taxable incomes[46] over

[43] The $100,000 threshold applies to taxpayers filing as married filing jointly. The threshold for taxpayers filing as head of household is $80,000; the threshold is $60,000 for single taxpayers; and the threshold is $50,000 for married filing separately.
[44] North Carolina income tax is the amount recorded on line 14 of NC D-400 tax form.
[45] North Carolina taxable income is the amount recorded on line 13 of the NC D-400 tax form.
[46] The graduated NC income tax rates are 6%, 7%, and 7.75%. The effective tax rates in the respective tax brackets for taxpayers subject to the 2% surtax are 6.12%, 7.14%, and 7.91% respectively.

$100,000 and up to $250,000; and it is 3% for taxable incomes[47] over $250,000. For heads of households, the thresholds are $80,000 and $200,000 respectively; for single taxpayers the thresholds are $60,000 and $150,000 respectively; and for married filing separately the thresholds are $50,000 and $125,000.

The income tax surtaxes imposed by this section are in addition to the corporate income tax and individual income tax owed by the taxpayer. The surtaxes are due at the same time as the filing of the tax return itself. For a corporate taxpayer, the tax is due on or before the fifteenth day of the third month following the close of its income year. For an individual taxpayer, the tax is due on or before April 15th.

The General Assembly made similar income tax adjustments during the budget shortfalls of 1991, 2001, and 2003. During the budget shortfall in 1991, the General Assembly imposed a temporary surtax on corporations in an amount equal to a stated percentage of the corporation's income tax liability.[48] During the budget shortfall in 2001, the General Assembly created a temporary 8.25% individual income tax bracket for incomes that exceeded $200,000 for taxpayers filing as married filing jointly. Under the 2001 legislation, the upper income tax bracket would have expired for taxable years beginning on or after January 1, 2004. In 2003, the General Assembly extended the 2004 sunset until 2006 and in 2005 it extended the sunset until 2007. In 2006, the General Assembly reduced the upper income tax rate from 8.25% to 8% for taxable year 2007. The temporary bracket expired for taxable years beginning on or after January 1, 2008.[49]

Increase Sales and Use Tax By One Percent. – Section 27A.2 increases General Fund revenues by approximately $803 million in fiscal year 2009-2010 and $1.1 billion for fiscal year 2010-2011 by imposing a temporary State sales and use tax increase of one percent, from 4.5% to 5.5%, effective September 1, 2009. The combined State and local tax rate in North Carolina based upon the highest possible county tax rate is 8.25%.[50] As of October 1, 2009, only 11 states have a higher combined sales tax rate than North Carolina.[51]

Effective October 1, 2009, the combined State and local rate will remain the same, but the allocation of the rate between the State and the counties will change based upon legislation enacted in 2007.[52] Effective October 1, 2009, the State sales tax rate is 5.75%. Effective July 1, 2011, the State rate will return to 4.75%.

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[47] The effective graduated tax rates for taxpayers subject to the 3% surtax are 6.18%, 7.21%, and 7.98%. Only nine states have a higher individual income tax rate than 7.98%: Hawaii, Oregon, California, New Jersey, Vermont, Rhode Island, Iowa, New York, and Maine.

[48] The percentage rate of the surtax was 4% for taxable year 1991. The rate fell by 1% each taxable year thereafter until it expired in taxable year 1995. See Chapter 689 of the 1991 Session Laws.

[49] S.L. 2001-424, S.L. 2003-284, S.L. 2205-276, and S.L. 2006-66.

[50] The local tax rate in most counties is 2.25%, making the combined State and local rate 7.75%. In 2007 the General Assembly authorized counties to impose an additional ¼ cent sales tax. As of October 1, 2009, eight counties have done so. In those counties, the combined rate is 8%. (Alexander, Catawba, Cumberland, Haywood, Martin, Pitt, Sampson, and Surry) Mecklenburg County has an additional ½ cent sales tax for public transit. The combined rate in Mecklenburg County is 8.25%.

[51] Kansas, Arizona, New York, Oklahoma, Washington, Missouri, Tennessee, California, Illinois, Arkansas, and Idaho.

[52] Section 31.16 of S.L. 2007-323. The State assumed 100% of the nonfederal, non-administrative share of Medicaid costs over a three-year period beginning in 2007. To provide the financial resources to assume these costs, the legislation phased out the third one-half cent local sales tax and made a corresponding increase in the State sales tax rate. Effective July 1, 2009, the State assumed the entire

A sale is complete when delivery is made to a customer. The new tax rate applies to taxable sales and purchases of property or services delivered on or after September 1, 2009, regardless of the date the order was placed, with the following exceptions:

- Gross receipts from the lease of tangible personal property that is delivered to a lessee prior to September 1, 2009, and leased for a definite stipulated period of time.
- Construction materials purchased or sold on and after September 1, 2009, to fulfill a lump-sum or unit-price contract entered into or awarded prior to September 1, 2009.

Section 22 of S.L. 2009-575 provides that a retailer is not liable for an over-collection or under-collection of sales tax for the period beginning September 1, 2009, and ending October 1, 2009, if the retailer made a good faith effort to comply with the law and collect the proper amount of tax and has, due to the increased State rate under this act, over-collected or under-collected the amount of sales tax due.

The General Assembly increased the State sales tax rate from 3% to 4% in 1991. In 2001, it enacted a temporary increase of ½ cent, making the State rate 4.5%. Under the 2001 legislation, the increased rate would sunset effective July 1, 2003. However the General Assembly extended the sunset date in 2003 and 2005, and it maintained ¼ cent of the increased rate in 2007 for a State tax rate of 4.25%.[53] The State rate changed from 4.25% to 4.5% as part of the Medicaid swap on October 1, 2008.[54]

Nexus Clarification and Click Throughs, Use Tax Line on Income Tax Return, Digital Products, Magazines Delivered by Mail. – Section 27A.3, which originated as a Revenue Laws Study Committee recommendation and was included in the House's version of the budget as well as in the proposed Senate tax plan, makes several changes related to the sales tax treatment of digital products and clarifies certain circumstances that satisfy the nexus requirement for purposes of requiring sales tax collection by a remote retailer. This section increases General Fund revenues by approximately $11.8 million in fiscal year 2009-2010 and $24.1 million in fiscal year 2010-2011.

- **Nexus Clarification and Click Throughs. –** This section provides that a remote retailer who enters into a 'click-through' contractual agreement with a North Carolina resident is soliciting business in this State for purposes of requiring a remote retailer to collect sales tax. This provision became effective when the act became law on August 7, 2009.

  G.S. 105-164.8 sets out the circumstances under which a remote retailer is required to collect sales tax on mail order sales. Generally speaking, a remote retailer is one that does not maintain a brick and mortar establishment in this State. This statute reflects principles promulgated in a series of cases that set out circumstances under which a retailer has sufficient nexus with a state to require it to collect sales tax. Several of these cases involved businesses that used independent contractors or other commissioned agents to solicit orders in a state in which the business was not physically located. One of the leading cases in this area is *Scripto v. Carson*, in which the United States Supreme Court held that a state could require tax collection by a remote retailer that had contracts with 10 in-state residents deemed independent contractors who solicited

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non-administrative, nonfederal share of Medicaid costs. The counties retained responsibility for the costs associated with administering Medicaid at the county level. Effective October 1, 2009, the State sales tax rate increased .25% to 4.75% and the local rate decreased .25%.

[53] S.L. 2001-424, 2003-284, 2005-276, 2006-66, 2007-145, and 2007-323.

[54] S.L. 2007-323.

orders for products on its behalf. This principle has been codified in G.S. 105-164.8, which states, in part, that a retailer who makes a mail order sale must collect the sales tax if:

> "The retailer has representatives in this State who solicit business or transact business on behalf of the retailer, whether the mail order sales thus subject to taxation by this State result from or are related in any other way to such solicitation or transaction of business."

This case reflected a business model that was common at the time. In recent years, with the growth of the Internet, a new business model has emerged as a way for online retailers to solicit business. Amazon is a prime example of this business model. Under what is referred to as an "affiliate program," Amazon enters into contractual agreements with the owners of other websites and pays a commission for sales that result from a "click-through" to the Amazon website from the other website. Through the operation of this program, Amazon has established nexus in this State by maintaining compensated representatives in the State who solicit business for Amazon. This principle is consistent with the holding of the *Scripto* case.

This section of the act revises the mail order sales provision in two ways. First, it changes the term "mail order sale" to "remote sale," which covers all transactions that are not face-to-face but reflects more modern terminology and the prevalence of Internet sales. Second, it provides that a retailer is presumed to solicit or transact business in this State and is, therefore, required to collect sales tax if all of the following conditions are met:

- The retailer has entered into an agreement with a resident of this State.
- Under the agreement, the resident receives a commission or other consideration in exchange for directly or indirectly referring potential customers, whether by a link on an Internet website or otherwise, to the retailer.
- The cumulative gross receipts from sales by the retailer to purchasers in this State who are referred to the retailer by all residents with this type of agreement with the retailer is in excess of $10,000 during the preceding four quarterly periods.

This presumption may be rebutted by proof that the resident with whom the retailer has an agreement did not engage in any solicitation in the State on behalf of the retailer that would satisfy the nexus requirement of the United States Constitution.

In a recent New York Supreme Court[55] case, Amazon challenged an identical provision in the New York sales tax statutes alleging that it violates the Commerce Clause of the United States Constitution as well as both the Federal and State Constitutions' Due Process and Equal Protection Clauses. The court dismissed the complaint for failure to state a cause of action. The court disagreed with Amazon's assertion that the commissioned agents were mere advertisers concluding that the provision requires tax collection only when an out-of-state seller avails itself of the benefit of in-state contractors who are compensated for referrals and who generate actual business for the seller. Moreover, the court stated that "Amazon should not be permitted to escape tax collection indirectly, through use of an incentivized New York sales force to generate revenue, when it would not be able to achieve tax avoidance directly through the use of New York employees engaged in the very same activities."

[55] The New York Supreme Court is a trial-level court.

Amazon is still in litigation in New York, but so far the courts have sided with the State and have found that this type of arrangement is sufficient to create nexus. Rhode Island enacted similar legislation during its recent legislative session. California and Hawaii did as well, but the measures were vetoed by their respective Governors. Several other states, such as Connecticut, Illinois, Minnesota, Tennessee, and Wisconsin, had similar legislation introduced but not enacted or are continuing to study the issue.

- **Digital Products. –** This section imposes the State and local general rate of sales and use tax on certain digital goods that are delivered or accessed electronically to the extent those items would be taxable if sold in a tangible medium. It also eliminates the general exemption for prewritten computer software that is delivered electronically with an exception for certain "enterprise" software.

  Under current law, the general rate of State and local sales and use tax applies to the sale, lease, or rental of tangible personal property and some services. Tangible personal property is defined as "personal property that may be seen, weighed, measured, felt, or touched, or is in any other manner perceptible to the senses." Digital goods, such as downloaded music and movies, are not tangible personal property, and, therefore, are not taxed. Prewritten computer software is specifically included within the definition of tangible personal property, but it is exempt from sales tax when it is delivered electronically or by load and leave.[56]

  When the Revenue Laws Study Committee examined the existing sales tax treatment of digital goods, three primary findings emerged leading to the recommendation of this provision. First, the Committee recognized that the sales and use tax statutes are outdated in relation to today's modern retail economy. The sales and use tax statutes were originally enacted in the 1930s and were drafted to apply to sales of tangible personal property because those items constituted the bulk of consumer purchases at that time. Technology and the prevalence of the Internet have transformed society in a number of ways, including the way in which consumers make purchases. Over the last 15 years, more and more consumers shop online and download or stream media in digital format. When the sales tax statutes were enacted, intangible digital goods were not in existence and therefore not contemplated under the tax code. However, purchases of media in digital format are quickly becoming the norm, and many states have been revisiting their sales tax statutes in order to bring them into the 21st Century. Second, the Committee also found that the sales and use statutes are inequitable to the extent that similar, if not identical, items are treated differently based upon the method of delivery or the point of purchase. This unequal treatment impacts consumers as well as retailers. For example, a consumer who purchases a CD in a brick and mortar retail establishment, such as Walmart, pays sales tax on that item. Likewise, a consumer who orders the CD from the Walmart website pays sales tax on that item. However, a consumer who downloads the exact same CD in MP3 format from the Walmart website would not pay any sales tax on the item. In these examples, the consumer purchases the same item, but the tax treatment differs. This differing tax treatment discriminates against consumers who either choose to purchase a tangible format or who do not have the technological capability to download or stream in digital format because they do not have a computer or high-speed Internet access. Moreover, the tax code should not drive consumer choice but it should be neutral as to industry, content, and delivery method. This unequal tax

[56] The term "load and leave" is defined as "delivery to the purchaser by use of a tangible storage media where the tangible storage media is not physically transferred to the purchaser."

treatment also places brick and mortar retailers, or at least those without an Internet presence, at a competitive disadvantage with Internet retailers. A sound tax structure is one that is fair and neutral. Taxing digital goods in the same manner as their tangible counterparts promotes these principles. Third, the Committee concluded that the State will lose significant sales tax revenue that it is currently collecting as consumers continue to transition from purchases of tangible media to purchases of digital media.

In light of these findings, the General Assembly enacted this provision, which imposes the general rate of sales and use tax on audio works, audiovisual works, books, magazines, newspapers, newsletters, reports, photographs, and greeting cards that are delivered or accessed electronically and that would be taxable if purchased in a tangible format, effective January 1, 2010. The tax applies regardless of whether the purchaser has a right to use it permanently or to use it without making continued payments. The tax does not apply to a service that is already taxed or to an information service. The purchase of a digital code used to obtain one of these items is considered a sale of that item.

The terms "audio work" and "audiovisual work" are defined terms under the Streamlined Sales Tax Agreement. An audio work is a series of musical, spoken, or other sounds and includes items such as recorded or live songs, music, readings of books or other written materials, speeches or ringtones or other sound recordings. An audiovisual work is a series of related images and any sounds accompanying the images that impart an impression of motion when shown in succession and includes movies, music videos, news, and entertainment programs.

This section also eliminates the exemption for prewritten computer software when delivered electronically. Under current law, prewritten computer software purchased in a tangible format is subject to tax. However, prior to this act, there was a specific exemption for prewritten computer software[57] delivered by load and leave or delivered electronically. In an effort to equalize the treatment of goods that are similar in substance and differ only in format, the General Assembly chose to eliminate this exemption. In doing so, it carved out a "business-to-business" exception for enterprise software, which is software used by large businesses to run office operations, such as billing. Thus, computer software meeting any of the following descriptions is exempt from sales and use tax:

- It is designed to run on an enterprise server operating system.
- It is sold to a person who operates a datacenter and is used within the datacenter.
- It is sold to a person who provides cable service, telecommunications service, or video programming and is used to provide ancillary service, cable service, Internet access service, telecommunications service, or video programming.

- **Magazines Delivered by Mail**. – This section eliminates the sales tax exemption for magazines delivered by mail. Under current law, magazine publishers and other retailers who are engaged in business in this State are liable for State and local sales tax on their over the counter sales of magazines. However, sales of magazines by magazine vendors making door to door sales and retail sales of magazines by subscription delivered through the mail to subscribers inside or outside North Carolina

[57] This act does not change the treatment of custom computer software, whether in tangible or digital format, which is exempt from sales and use tax.

are exempt from tax. In an effort to equalize the sales tax treatment of magazines, this section repeals the exemption for magazines delivered by mail. This section did not, however, change the current exemption for sales of newspapers by newspaper street vendors, by newspaper carriers making door to door deliveries, and by means of vending machines.

- **Use Tax Line on Income Tax Return. –** Finally, this section maintains the requirement that use tax be paid annually with the filing of an individual income tax return, which was set to expire on January 1, 2010. Had the provision expired, an individual still would have been required to pay use tax, but using a separate form and following the schedule for the remittance of sales taxes.

  An individual who purchases tangible personal property, other than boats and aircraft, outside the State for a non-business purpose is required to accrue and remit the use tax due on an annual basis. In 1999, in order to simplify and improve use tax collection, the General Assembly enacted legislation requiring that an individual who owes use tax and who is required to file an individual income tax return must pay the use tax with the individual income tax return. The Secretary is required to provide appropriate space and information on the individual income tax form for the reporting of use tax. By placing the use tax on the individual income tax return, as opposed to a separate return, the hope was to raise taxpayer awareness of the obligation to report and pay the tax.

  In 2000, the General Assembly repealed the requirement that the use tax line be included and paid with the individual income tax return, to become effective January 1, 2003. The rationale for the repeal was that once the Streamlined Sales Tax Project requiring out-of-state retailers to collect sales tax was fully implemented, there would be no need to report use tax. In 2003, the General Assembly delayed the repeal by two years. Then, in 2005, the repeal was delayed again until January 1, 2010, since Congress had not yet acted on this issue. This section of the budget eliminates the repeal set to take place in 2010, which means that the use tax will still be required to be paid annually on an individual's income tax return.

Alcohol Excise Tax Changes. – Section 27A.4 increases General Fund revenues by approximately $57.7 million for fiscal year 2009-2010 and $47 million in fiscal year 2010-2011, by increasing the excise tax rate on alcohol and by retaining part of the beer and wine revenues distributed to local governments. The State shares a percentage of the excise taxes collected on beer and wine with the counties or cities in which the retail sale of these beverages is authorized. The distribution is made annually for the preceding 12-month period ending March 31. Under this section, the State will retain approximately 70% of the revenues for the 12-month period ending March 31, 2010. This section also reduces the percentage of the revenues distributed in the future so that 100% of the revenues derived from the increased tax rates in this section will go to the State.

This section increases the excise tax rate on beer, wine, and liquor as follows:

- The excise tax rate on beer increased from 53.177¢ per gallon to 61.71¢ per gallon effective September 1, 2009. The rate increase means the tax on a can of beer changes from 5¢ a can to 5.8¢ a can, or about a 5¢ increase in the cost of a six-pack. The tax rate has not been increased since 1969. Four states have a higher tax rate on beer.[58] Beer is also subject to a federal excise tax of approximately 5¢ per can.

[58] South Carolina, Hawaii, Alabama, and Alaska.

- The excise tax rate on unfortified wine[59] increased form 21¢ per liter to 26.34¢ per liter, effective September 1, 2009. The excise tax rate on fortified wine increased from 24¢ per liter to 29.34¢ per liter, effective September 1, 2009. The rate increase means the tax on a bottle of wine changes from approximately 16¢ a bottle to 20¢ a bottle. The tax rate does not appear to have been increased since 1969. Twelve states have a higher tax rate on wine.[60] Wine is also subject to a federal excise tax that ranges from 21¢ per bottle to 62¢ per bottle, depending upon the alcohol content.

- The excise tax rate on liquor sold in an ABC store increased from 25% of the taxable sale to 30% of the taxable sale, effective September 1, 2009. North Carolina last changed the taxation of liquor in 2001.[61] Five states have a higher tax rate on liquor.[62] Liquor is also subject to a federal excise tax of approximately $2.14 per bottle.

Tobacco Products Excise Tax Changes. – Section 27A.5 increases General Fund revenues by approximately $38 million for fiscal year 2009-2010 and $54.5 million for fiscal year 2010-2011, by increasing the excise tax rate on tobacco products as follows:

- The excise tax rate on cigarettes increased from 1.75¢ per cigarette to 2.25¢ per cigarette, effective September 1, 2009. This tax rate equates to a 10¢ increase in a pack of cigarettes, from 35¢ to 45¢. The General Assembly last increased the excise tax on cigarettes in 2005, when it increased the rate from 5¢ a pack to 35¢ a pack.[63] Only five states have a tax rate lower than 45¢.[64] Cigarettes are also subject to a federal excise tax of $1.01 per pack.

- The excise tax rate on other tobacco products increased 2.8%, from 10% of the cost price of the product to 12.8%. The General Assembly increased the excise tax on other tobacco products from 2% to 3% in 2005.[65] In 2007, it increased the rate from 3% to 10% and earmarked the revenues derived from the increase to the University Cancer Research Fund.[66] The increase in revenues derived from the increase in this section will also be credited to the University Cancer Research Fund. However, the General Fund still benefits from the increased revenue since it will not have to appropriate this amount to the Cancer Research Fund from the State's General Fund.[67] Other tobacco products

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[59] The difference between fortified and unfortified wine is the percentage of alcohol by volume that it contains. Unfortified wine is a wine that has 16% or less alcohol; fortified wine is a wine that has more than 16% but no more than 24% of alcohol.

[60] West Virginia, Montana, Tennessee, Pennsylvania, Hawaii, Georgia, Virginia, Alabama, New Mexico, Iowa, Florida, and Alaska.

[61] Prior to 2001, the excise tax on liquor was in lieu of the sales tax. In S.L. 2001-424, the State began imposing a State sales tax on liquor equal to the combined State and local sales tax rate. To recognize the change in taxation, the General Assembly reduced the excise tax on liquor from 28% to 25%.

[62] Alaska, Virginia, Vermont, Oregon, and Washington.

[63] S.L. 2005-276. The rate increased from 5¢ a pack to 30¢ a pack, effective September 1, 2005, and to 35¢ a pack, effective July 1, 2006.

[64] South Carolina, Missouri, Kentucky, Louisiana, and Georgia.

[65] S.L. 2005-276.

[66] S.L. 2007-323.

[67] G.S. 116-29.1 establishes the University Cancer Research Fund and provides a minimum funding of $50 million for the Fund. Of this amount, $8 million is credited to the Fund from the Tobacco Trust Account. An amount equal to the difference between $50 million and the amounts credited to the Fund from the Tobacco Trust Account and the funds remitted from the OTP tax revenue is appropriated to the Fund from the General Fund.

are also subject to a federal excise tax. The federal government taxes little cigars the same as cigarettes. The federal excise tax on other tobacco products varies depending upon the product.

IRC Conformity. – Section 27A.6 updates from May 1, 2008 to May 1, 2009, the reference to the Internal Revenue Code used in defining and determining certain State tax provisions.

North Carolina's tax law tracks many provisions of the federal Internal Revenue Code by reference to the Code.[68] The General Assembly determines each year whether to update its reference to the Internal Revenue Code.[69] 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.

Changing the reference date to May 1, 2009, incorporates the majority of changes made by the five federal acts listed below, with several significant exceptions. This conformity will result in a loss to the General Fund of $116.1 million in fiscal year 2009-2010 and $80.9 million in fiscal year 2010-2011. The federal acts are:

- Heartland, Habitat, Harvest, and Horticulture Act of 2008 signed into law May 22, 2008 (P.L. 110-234).
- Heroes Earnings Assistance and Relief Tax Act of 2008 signed into law June 17, 2008 (P.L. 110-245).
- Emergency Economic Stabilization Act of 2008 (EESA) signed into law October 3, 2008 (P.L. 110-343).
- Worker, Retiree, and Employer Recovery Act of 2008 signed into law December 23, 2008 (P.L. 110-458).
- American Recovery and Reinvestment Tax Act of 2009 (ARRTA) signed into law February 17, 2009 (P.L. 111-5).

The following is a list of changes to which the General Assembly chose not to conform; below that list begins a description of the major federal tax changes under each of the above-referenced acts to which North Carolina is conforming. The provision related to the real property tax deduction for non-itemizers is effective for taxable years beginning on or after January 1, 2008. The remaining provisions are effective for taxable years beginning on or after January 1, 2009.

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[68] 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.

[69] 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."

- Real property tax deduction for non-itemizers.[70]
- Income tax deduction for sales or excise taxes on new vehicle purchases.
- Extension of bonus depreciation.[71]
- For corporate filers only, the five-year carryback period for net operating losses attributable to a federally-declared disaster occurring during 2009[72] and for net operating losses of small businesses.
- Delayed recognition of certain cancellation of debt income.
- Suspension of applicable high-yield discount obligation rules for certain high-yield obligations.

Heartland, Habitat, Harvest, and Horticulture Act of 2008

- *Endangered species recovery expense.* – This act creates a new deduction for endangered species recovery expenditures for expenses incurred after December 31, 2008. Farmers may currently claim a deduction for qualifying soil and water conservation expenditures and land erosion prevention expenditures. The deduction is limited to 25% of gross income derived from farming during the tax year but can be carried forward indefinitely. This act adds endangered species recovery expenditures to the category of expenditures that qualify for the deduction. The expenditures must be paid or incurred by a farmer after December 31, 2008 for the purpose of site-specific management actions recommended in recovery plans approved pursuant to the Endangered Species Act of 1973. Depreciable structures, appliances, or facilities do not qualify for the deduction.
- *Charitable Contributions of Real Property for Conservation Purposes.* – This act extends the increased deduction for charitable contributions of real property for conservation purposes for tax years beginning before January 1, 2009. The deduction for capital gain appreciated real property is generally limited to 30% 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% of the donor's adjusted gross income.[73] Deductions for donations to non-maximum donation organizations are limited to 20% of the donor's adjusted gross income. Contributions that exceed the deduction limit can be carried forward for five years. The Pension Protection Act of 2006 increased the deduction for donations of conservation easements. An individual may deduct the value of the easement, based on fair market value, up to 50% 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% of adjusted gross income with a 15-year carryforward. A "qualified farmer or rancher" is an

[70] This was included in the Housing Assistance Tax Act of 2008 signed into law July 30, 2008 (P.L. 110-289).
[71] See explanation below of modified conformity under *Business Tax Relief* in the section describing changes made by the **American Recovery and Reinvestment Tax Act of 2009**.
[72] This was included in the Emergency Economic Stabilization Act of 2008.
[73] 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.

individual whose gross income from the trade or business of farming is greater than 50% 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 act extends these provisions through December 31, 2009.

Heroes Earnings Assistance and Relief Tax Act of 2008

- *State or Local Bonuses for Combat Veterans.* – The act excludes state or local bonuses for combat veterans from gross income for income tax purposes. Generally all income is included in gross income unless the income is explicitly excluded. "Qualified military benefits" are excluded from gross income. These benefits generally include allowances or in-kind benefits provided to family members and former members of the armed services, or their dependents by reason of the member's service, including housing, moving, and travel allowances. This act expands the definition of "qualified military benefits" to include bonus payments by a state or local government to a member or former member of the armed services, or to a dependent of a member. To qualify for the exclusion, the payment must have been made for the member's service in a combat zone.[74]

- *Contributions of Military Death Gratuities to Roth IRAs and Coverdell ESAs.* – The act allows military death gratuities to be contributed to a Roth IRA or Coverdell ESA regardless of contribution limits and income phase-out limits for Roth IRAs and Coverdell ESAs. Upon notification of the death of military personnel on active duty or on inactive duty training, a death gratuity is paid to or for the person's survivor. The death gratuity is a qualified military benefit and excluded from income. Roth IRAs are subject to annual contribution limits equal to the lesser of the statutory dollar amount or 100% of taxable income. For 2008, the annual limit on contributions is $5,000 for individuals, with an additional catch up contribution of $1,000 allowed for individuals over age 50. Sums may be rolled-over from eligible retirement plans to Roth IRAs, subject to income-phase out limitations. For 2008, rollovers are allowed for individuals whose gross adjusted income does not exceed $100,000. A Coverdell Education Savings Account is a tax-exempt trust created for paying the education expenses of the trust's designated beneficiary. Annual contributions to Coverdell ESAs may not exceed $2,000. This act allows the gratuity to be contributed to a Roth IRA or Coverdell ESA regardless of contribution limits and income phase-out limits for Roth IRAs and Coverdell ESAs.

Emergency Economic Stabilization Act of 2008

The major provisions of this act that impact North Carolina revenues and to which North Carolina is conforming are as follows:

- *Extension of Income Exclusion for Discharged Indebtedness on Principal Residence.* – The act extends the exclusion from income for discharged indebtedness on principal residences for discharges occurring before January 1, 2013. When a lender forecloses on property, sells the home for less than the borrower's outstanding mortgage and forgives all or part of the unpaid mortgage debt, the canceled debt is considered income under the Code. There is no income limitation, but no more than $2 million in mortgage debt is eligible for exclusion. The exclusion from income for discharged indebtedness related to a principal residence is for the three-year period beginning January 1, 2007 and ending December 31, 2009. This act extends the exclusions for

[74] A combat zone is defined as any area the President has by executive order designated an area in which the Armed Forces are or have engaged in combat.

discharged indebtedness related to a principal residence for the period beginning January 1, 2007 and ending on December 31, 2012.

- *Charitable Contributions from IRAs Restored.* – The act extends the favorable treatment of qualified charitable distributions from IRAs for two years, for distributions made in 2008 and 2009. 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 distribution is not attributable to a return of a nondeductible contribution. The standard charitable deduction rules then apply to the donation. The Pension Protection Act of 2006 provided that individuals 70 ½ or older could 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 towards the required minimum distribution. This provision was set to expire in 2007, but the act extends the provision through 2009.

EESA made several changes related to the Modified Accelerated Cost Recovery System (MACRS) as follows:

- *15-Year MACRS Recovery Period for Qualified Leasehold Improvements and Qualified Restaurant Improvements and Buildings.* – The act extends for two years the 15-year Modified Adjusted Cost Recovery System (MACRS) recovery period for qualified leasehold improvements and restaurant improvements and buildings. The 15-year recovery period applies to property placed in service before January 1, 2010. The act also creates a 15-year MACRS recovery period for qualified retail improvement property and applies to property placed in service after December 31, 2007 and before January 1, 2010. The building must be at least three years old when the improvement is placed in service. Before these provisions, the improvements would generally be considered a structural component of the building and would be depreciated over a 39-year period.

- *Seven-Year Depreciation Period for Motorsports Facilities.* – The act extends the 7-year MACRS recovery period for motorsports entertainment complexes to property placed in service in 2008 and 2009. Historically, race tracks and facilities were treated by the IRS the same as theme and amusement parks. The American Jobs Creation Act of 2004 codified this treatment. A "motorsports entertainment complex" is a racing track facility that is permanently situated on land, hosts at least one racing event for cars of any type, trucks, or motorcycles during the 36-month period following the first day of the month in which it is put in service, and is open to the public for an admission fee.

- *Certain Farming Equipment Business Machinery or Equipment Treated as Five-Year Property.* –The act provides that certain machinery or equipment used in a farming business is treated as five-year property for purposes of claiming MACRS depreciation. The equipment does not include grain bins, cotton ginning assets, fences, or land improvements. Property that is used in a farming business can be depreciated under the General Depreciation System (GDS) using the 150-percent declining-balance method. Farm machinery and equipment generally has a recovery period of 10 years and has a straight-line recovery method.

EESA also extended a number of deductions and an expensing election:

- *Deduction for Qualified Tuition and Related Expenses.* – The act extends the deduction for qualified tuition and related expenses for tax years beginning before January 1, 2010. The expenses eligible for the deduction include tuition and fees required for the enrollment or attendance of the taxpayer, the taxpayer's spouse, or dependent at an eligible institution of higher education. The maximum deduction is $4,000 for taxpayers whose AGI does not exceed $65,000 ($130,000 for joint filers) and $2,000 for taxpayers whose AGI does not exceed $80,000 ($160,000 for joint filers).

- *Above-the-Line Deduction for Certain Expenses of School Teachers.* – The act extends the above-the-line deduction for eligible educators for tax years beginning in 2008 and 2009. The $250 deduction is allowed for books, supplies, and computer equipment purchased by an eligible educator for use in the classroom.

- *Enhanced Deduction for Charitable Contributions of Computers.* – The act extends the enhanced deduction for charitable contributions of computers for tax years beginning in 2008 and 2009. C corporations that make qualified contributions of computer technology and equipment may claim an enhanced deduction equal to the corporation's basis in the donated property plus one-half of the ordinary income that would have been realized if the property had been sold. The enhanced deduction may not exceed twice the corporation's basis in the property.

- *Enhanced Deduction for Charitable Contributions of Food Inventory.* – The act extends the enhanced deduction for charitable contributions of food inventory for tax years beginning in 2008 and 2009. Taxpayers may take a deduction for donated food inventory equal to the lesser of (1) the donated item's basis plus one-half of the amount of gain that would be realized if the donated food item was sold at fair market value, or (2) two times the donated item's basis. The deduction is limited to 10% of the taxpayer's net income, however, the 10% limitation is suspended for contributions made by farmers or ranchers between October 3, 2008 and January 1, 2009.

- *Enhanced Deduction for Charitable Contributions of Book Donations.* – The act extends the enhanced deduction for charitable contributions of book donations for tax years beginning in 2008 or 2009. Any corporation, other than an S corporation, can take an enhanced deduction for contributions of book inventory equal to the lesser of (1) the donated inventory item's basis plus one-half of the item's appreciation, or (2) two times the donated inventory item's basis.

- *Deduction for Environmental Remediation Costs.* – The act extends the election to deduct environmental remediation costs to cover expenditures paid or incurred in 2008 and 2009. A taxpayer may elect to deduct certain environmental cleanup costs in the tax year paid or incurred, rather than capitalize them. The election only applies to costs that are incurred in connection with the abatement or control of hazardous substances at a "qualified containment site," also called a "brownfield site."

- *Deduction for Energy Efficient Commercial Buildings.* – The act extends the deduction for energy efficient commercial building property for five years and is available for qualified property placed into service after December 31, 2005 and before January 1, 2014. The deduction applies to "energy efficient commercial building property," which is defined as depreciable property that is installed as part of a building's interior lighting systems, HVAC and hot water systems, or building envelope systems, and is part of a certified plan to reduce the total annual energy and power costs of these systems

by at least 50%. The deduction is limited to the product of $1.80 and the total square footage of the building, reduced by the aggregate amount deducted in any prior year.

- *Extend and Modify Treatment of Certain Qualified Film and Television Productions.* – The act extends the expensing election related to film and television productions for one year for productions that begin before January 1, 2010, and allows the election to be made, in part, for productions with aggregate costs over the dollar production limit. A taxpayer may deduct the production costs of a qualifying film or television production. To qualify for the election, the aggregate production cost may not exceed $15 million. This act modifies the provision so that the first $15 million of otherwise qualifying film or television productions may be treated as an expense even if the aggregate cost of production exceeds $15 million.

EESA made the following changes related to disaster relief:

- *Relief for Midwestern Disaster Areas.* – The act modifies and extends many of the tax benefits extended to the victims of Katrina, Wilma, and Rita hurricanes to the victims of storms that hit the Midwest in the summer of 2008. These include the extension of special expensing for qualified property, an enhanced low-income housing credit, and flexible tax-exempt bond financing rules.

- *Casualty Losses Attributable to Federally Declared Disasters.* – The act increases the deduction for casualty losses attributable to federally declared disasters for tax years beginning after December 31, 2007. Personal casualty losses are deductible to the extent the losses exceed $100 per casualty and the sum of the casualty losses exceed 10% of the taxpayer's AGI. For tax years beginning after December 31, 2007, the standard deduction is increased by the amount of any disaster loss amount for casualty losses attributable to a federally declared disaster occurring in 2008 and 2009. The losses are deductible without regard to whether the losses exceed 10% of a taxpayer's adjusted gross income. The deduction for any casualty attributable to a federally declared disaster occurring in 2009 is limited to the amount of the loss that exceeds $500.

- *Expensing of Qualified Disaster Costs.* – The act allows a taxpayer to elect to expense qualified disaster expenses after 2007 rather than capitalizing them. Qualified disaster expenses include any expenditure that is all of the following:

    1. Paid or incurred in connection with a trade, business, or business-related property.
    2. Otherwise chargeable to a capital account.
    3. Made for any of the following:
        a. The abatement or control of hazardous substances that were released on account of a federally declared disaster.
        b. The removal of debris from, or the demolition of structures on, business-related property that is damaged as the result of a federally declared disaster.
        c. The repair of business-related property damaged as a result of a federally declared disaster.

- *Net Operating Losses Attributable to Federally Declared Disasters.* – The act creates a special five-year carryback period for net operating losses (NOLs) related to qualified disaster loss. In general, NOLs may be carried back and deducted against taxable income in the two tax years before the NOL year, and then carried forward and applied against taxable income for up to 20 years after the NOL year. The bill would allow a taxpayer to take the loss in three equal installments in taxable years 2010, 2011, and 2012.

- *Special Depreciation Allowance for Qualified Disaster Assistance Property.* – EESA allows an additional 50% depreciation allowance to be claimed for real and personal business property that is purchased to rehabilitate or replace similar property that is destroyed or condemned as a result of a residentially declared disaster for property placed in service after December 31, 2007, with respect to disasters declared after that date and occurring before January 1, 2010. North Carolina will conform to this provision in a modified way, just as it has with other bonus depreciation provisions enacted by Congress over the last decade. Like the bonus depreciation provision under ARRTA, a taxpayer will be required to add back 85% of the accelerated depreciation amount[75] in the year that it is claimed for federal purposes. Then, for tax years beginning on or after January 1, 2009, taxpayer may deduct from federal taxable income the total amount of the add-back required for either the 2007 or 2008 tax year, divided into five equal installments.

- *Increased Expensing for Qualified Disaster Assistance Property.* – The act increases the maximum section 179 expense allowance and investment limitation amount for qualified section 179 disaster property placed in service after 2007. In general, a qualifying taxpayer may elect to treat the cost of certain property as an expense and deduct it in the year the property is placed in service instead of depreciating it over several years. This property is frequently referred to as section 179 property, after the relevant section in the Internal Revenue Code. To be eligible, the property must be tangible personal property which is actively used in the taxpayer's business for which a depreciation deduction would be allowed. The property must be used more than 50% for business and must be newly purchased property. Generally, taxpayers take expensing first and claim section 168(k) depreciation on any remaining basis. First year expensing and investment are increased for disaster property as follows:

    1. The section 179 expense deduction ($250,000 for 2008) is increased by the lesser of $100,000 or the cost of the qualified section 170 disaster assistance property placed in service during the tax year.

    2. The amount of the investment limitation ($250,000 for 2008) is increased by the lesser of $600,000 or the cost of qualified section 179 disaster assistance property placed in service during the tax year.

American Recovery and Reinvestment Tax Act of 2009 (ARRTA)

This massive stimulus package, with a total cost of $787 billion, included $300 billion in tax relief. Of the tax provisions that impact North Carolina revenues, this section, except where noted, conforms to the following changes:

INDIVIDUAL TAX RELIEF

[75] The accelerated depreciation amount for property placed in service in 2008 is 50%.

- *Increase in EITC.* – Under federal law, a refundable earned income tax credit is available to certain low-income individuals. The amount of credit varies depending on the number of the taxpayer's qualifying children. ARRTA temporarily increases the credit from 40% to 45% of a family's first $12,570 of earned income for families with three or more children and increases the beginning point of the phase-out range for married couples filing a joint return by $1,880. North Carolina piggybacks this federal credit. A taxpayer who claims the federal EITC is allowed a refundable credit against North Carolina taxable income equal to 5% of the amount of credit the individual qualified for at the federal level.[76] Therefore, since the federal benefit is increasing, the State benefit will increase as well for the eligible individuals.

- *Temporary Suspension of Taxation of Unemployment Benefits.* – ARRTA allows an individual to exclude from gross income up to $2,400 of unemployment compensation received for 2009. Any unemployment benefits over $2,400 will be subject to federal income tax. Unemployment benefits include payments under federal or state law, disability payments received as a substitute for unemployment benefits, and payments under certain legislative acts and other benefit programs. Since the starting point for taxable income in North Carolina is federal taxable income, this exclusion will flow through at the State level and the income will not be subject to State income tax.

- *Transit Benefits Parity.* – ARRTA temporarily increases the monthly income exclusion for certain transit benefits accepted by employees between February 17, 2009 and January 1, 2011. Under current law, employers may extend transit benefits to employees as fringe benefits to offset commuting costs. Although compensation for services is generally taxable, qualified transportation fringe benefits provided by an employer to an employee are excluded from an employee's gross income for income tax purposes and from wages for payroll tax purposes. With this new provision, employees may deduct $230 per month (increased from $120) for these expenses through 2010. This provision applies specifically to van pool benefits and transit benefits provided by an employer to an employee, so as to provide parity with an existing deduction for individual parking benefits.

BUSINESS TAX RELIEF

- *Expansion of the Work Opportunity Tax Credit.* – ARRTA extends the existing Work Opportunity Tax Credit to two new targeted groups of prospective employees: (1) unemployed veterans and (2) disconnected youth. Businesses hiring new employees from these targeted groups in 2009 and 2010 will be entitled to claim the credit in an amount equal to 40% of the first $6,000 of wages paid to those employees during the first year of employment. An "unemployed veteran" is one who was discharged or released from active duty from the Armed Forces during the five-year period prior to hiring and received unemployment compensation for more than four weeks during the years before being hired. A "disconnected youth" is one between the ages of 16 and 25 and has not been regularly employed or attended school in the past six months. North Carolina also piggybacks this federal credit. A taxpayer who is allowed the federal credit may take a State credit[77] in an amount equal to 6% of the amount of credit allowed under the Code for wages paid during the taxable year for positions located in this State. A

[76] G.S. 105-151.31
[77] G.S. 105-129.16G.

position is located in this State if more than fifty percent (50%) of the employee's duties are performed in the State.

- *Extension of Bonus Depreciation.*[78] –The General Assembly decoupled from the extension of the bonus depreciation provisions in a manner similar to what it has done in the past by delaying the impact of the deduction. Taxpayers will be required to add back 85% of the accelerated depreciation amount[79] in the year that it is claimed for federal purposes. Then, for tax years beginning on or after January 1, 2009, taxpayer may deduct from federal taxable income the total amount of the addback required for either the 2007 or 2008 tax year, divided into five equal installments. This means that for State tax purposes, a taxpayer may deduct a greater depreciation amount in the outlying tax years, which will be the normal depreciation amount plus 20% of the accelerated depreciation amount the taxpayer had to add back. Over the life of an asset placed in service during 2008, taxpayers will be able to deduct the same amount of the asset's basis under both federal and State law; it is just that the timing of the deduction will differ.

- *Extension of Enhanced Small Business Expensing.* – This section conforms to the increased expensing limits authorized under EESA and extended under ARRTA by one year. In general, a qualifying taxpayer may elect to treat the cost of certain property as an expense and deduct it in the year the property is placed in service instead of depreciating it over several years. This property is frequently referred to as section 179 property, after the relevant section in the Code. To be eligible, the property must be tangible personal property that is actively used in the taxpayer's business for which a depreciation deduction would be allowed. The property must be used more than 50% for business and must be newly purchased property. Generally, taxpayers take the expensing deduction first and claim section 168(k) depreciation on any remaining basis.

  Prior to the EESA, the deduction was limited to $128,000 of the cost of the property with a phase-out at $510,000 for 2008. The new law temporarily doubles the limitation to $250,000[80] and increases the phase-out to $800,000. These limitations apply only to property purchased and placed in service in tax years beginning in 2008.

- *Five-Year Carryback of NOL for Small Businesses (for individual filers only).* – Taxpayers that sustain a net operating loss (NOL) for a tax year generally can take an NOL deduction to reduce income in another tax year. Under ARRTA, taxpayers can elect to carry back 2008 NOLs for three, four or five years, instead of the normal two years. An eligible business is defined as a corporation, partnership or sole proprietorship that had average annual gross receipts of no more than $15 million for the tax year of the NOL and the two immediately preceding tax years. A taxpayer may also elect to apply

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[78] Bonus depreciation allows a business to claim more of a deduction up front and spread the remainder out over the normal depreciation schedule. However, over the life of the asset the taxpayer still receives the same benefit. Congress has authorized bonus depreciation several times to encourage business investment, specifically after September 11, 2001. The Jobs Creation and Worker Assistance Act of 2002 provided a 30% bonus depreciation allowance. The Jobs and Growth Tax Relief Reconciliation Act of 2003 extended the sunset and increased the amount to 50%. There were bonus depreciation provisions in both the Emergency Economic Stabilization Act of 2009 and the American Recovery and Reinvestment Tax Act of 2009.

[79] The accelerated depreciation amount for property placed in service in 2008 is 50%.

[80] The new law does not alter the section 179 limitation imposed on sport utility vehicles, which have an expense limit of $25,000.

the extended carryback period to NOLs incurred in a tax year beginning in 2008, rather than in a tax year ending in 2008. This section allows individual filers who qualify to take advantage of the five-year carryback period at the State level. North Carolina did not, however, conform to this change for corporate filers. Under current State law, corporations must add back net operating losses. Therefore, nonconformity to this provision under EESA and ARRTA for corporate filers is consistent with current tax treatment.

- *Small Business Capital Relief*. – ARRTA temporarily increases from 50% to 75% the exclusion for qualified small business stock sold by an individual. The increased exclusion percentage is applicable to stock acquired after February 17, 2009 and before January 1, 2011. The percentage exclusion does not apply to the sale or exchange of certain empowerment zone stock. When the stock is issued, the gross assets of the issuing corporation may not exceed $50 million and the corporation must have at least 80% of the value of its assets used in the active conduct of one or more qualified trades or businesses.

- *Modification of § 382 Rules for Business Receiving TARP Funds*. – Under current law, when the ownership of a corporation changes, § 382 may be triggered to limit the use of the corporation's pre-change losses. ARRTA provides a narrow exception to the application of the § 382 limitation, which is normally triggered when ownership change occurs in a corporation that has a net operating loss, a NOL incurred in the year of the change, or a net unrealized built-in loss (NUBIL). ARRTA modifies the limitation so that it does not apply if the ownership change (1) occurs under a restructuring plan required under a loan agreement or a commitment for a line of credit entered into with the U.S. Treasury under EESA, and (2) is intended to result in a rationalization of the costs, capitalization, and capacity of the manufacturing workforce (and suppliers to) the taxpayer and its subsidiaries.

Study of North Carolina's Sales and Income Tax Structure. – Section 27A.7 authorizes the Finance Committees of the Senate and House of Representatives to meet during the interim to study and recommend legislation to reform North Carolina's tax structure. The Senate began this study during the legislative session. This study would be a joint effort by both legislative houses to reform North Carolina's tax system to reflect the current economy rather than the 1933 economy and to make the State's tax system more progressive and fairer so that individual taxpayers and business taxpayers who are in similar circumstances to one another are treated similarly by the tax system.

The State's experience with revenue shortfalls over the last 20 years has led to the creation of several study committees, both inside and outside the General Assembly, charged with the task of developing a 21st Century tax policy for the State. The last study committees to consider these issues include the Governor's Commission to Modernize State Finances, the Institute for Emerging Issues, the State and Local Fiscal Modernization Committee, and the Joint Select Committee on Economic Development Incentives. The Senate Finance Committee heard several presentations regarding the work of these committees.[81] The studies all proposed expanding the State's tax bases and eliminating tax exemptions, deductions, and credits. The Senate Finance Committee discussed a 21st Century Tax Modernization Plan based upon the recommendations of these study committees. The plan expands several of the State's tax bases

[81] February 18, 2009; February 25, 2009; March 4, 2009; April 15, 2009; April 22, 2009; June 3, 2009; July 28, 2009.

and lowers tax rates. The intent of the plan is to provide the State with a more stable tax structure that balances the different types of taxes and the different groups of taxpayers and to avoid increasing revenues through temporary, expedient changes.

REAL PROPERTY SALES INFORMATION.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-454	**SB 405**	**Senator Hartsell**

AN ACT TO ASSIST COUNTIES AND THE DEPARTMENT OF REVENUE IN OBTAINING ACCURATE REAL PROPERTY SALES INFORMATION NEEDED FOR PROPERTY TAX APPRAISALS.

OVERVIEW: This act, which was a recommendation of the Revenue Laws Study Committee, requires that a deed conveying real property and presented for registration before the register of deeds contain the following information:

- The name of each grantor and grantee and the mailing address of each grantor and grantee.
- A statement whether the property includes the primary residence of a grantor.

FISCAL IMPACT: No General Fund impact.

EFFECTIVE DATE: This act becomes effective January 1, 2010.

ANALYSIS: Beginning January 1, 2010, a deed[82] conveying real property and presented for registration with the register of deeds must include the following information on the deed:

- The name and mailing address of each grantor and grantee. This information will assist counties in collecting property taxes.
- A statement whether the property includes the primary residence of the grantor. This information will assist the Department of Revenue in determining whether income taxes are due such as on the sale of a vacation home or rental property.

Failure to provide this information on the deed will not affect the validity of a duly recorded deed. The act also reinstates the duty of the person presenting the instrument for registration to report the correct amount of tax due. An excise tax on conveyances is collected by the register of deeds when a deed is recorded. The rate is $1.00 for each $500 of the value of property conveyed. The correct amount of excise tax will assist the counties in determining accurate appraisals of real property for taxation purposes. This statutory duty was repealed in 2000 when legislation was enacted to eliminate the use of stamps on deeds.[83]

The Revenue Laws Study Committee had recommended to the 2009 General Assembly that a statewide sales information report be filed along with a deed and that this document also contain a brief description of the property conveyed, the total sales price, whether the transaction involved relatives or related businesses, whether personal property was conveyed

[82] The act does not apply to deeds of trust, deeds of release, or similar instruments.

[83] Prior to 2000, the registers of deeds affixed tax stamps on a deed to indicate that the excise tax on a conveyance had been paid. The use of these stamps was eliminated when metering machines and similar equipment became available.

with the transaction, and whether the transaction was the result of an auction or foreclosure sale. This sales information report was supported by tax assessors from large urban counties and smaller rural counties as well as the Property Tax Division within the Department of Revenue as a tool to assist the counties in meeting the statutory fair market appraisal standards. G.S. 105-283 requires that all property be appraised at its true value or market value for property tax purposes. To assist the counties in determining true value, the Department of Revenue conducts yearly sales assessment ratio studies for every county. These studies compare the appraised value of parcels with the sales price. The closer the comparison is to 100%, the closer the property's appraised value is to its fair market value. It was the opinion of this group that the information in the report would assist the Department in determining the true value of property in the counties while weeding out transfers of property that did not reflect payment of the property for fair market value. The Department of Revenue also noted that fifty counties currently send out letters requesting similar sales information and six counties require either transfer affidavits or copies of the sales contract.[84]

During the 2009 Session, the Revenue Laws Committee proposal was simplified by eliminating a separate report as well as disclosure of certain sales information. The General Assembly decided it was unnecessary to require parties to pay to record a separate document with the register of deeds as long as the required information was on the deed. The General Assembly also felt that a duty to report the correct amount of excise tax on the conveyance was sufficient notice of the sales price to assist the county in meeting the statutory fair market appraisal standards.

WITHHOLDING ON CONTRACTORS IDENTIFIED BY ITIN.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-476	**SB 1006**	**Senator Hoyle**

AN ACT TO REQUIRE WITHHOLDING ON CONTRACTORS IDENTIFIED BY AN INDIVIDUAL TAXPAYER IDENTIFICATION NUMBER (ITIN).

OVERVIEW: This act, which was a request of the Department of Revenue, requires a person who pays an Individual Taxpayer Identification Number (ITIN) holder more than $1,500 a year in compensation other than wages to withhold 4% of the compensation.

FISCAL IMPACT: The act is estimated to generate $8 million in fiscal year 2009-2010, and potentially $18 million in subsequent fiscal years. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2009 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act is effective for taxable years beginning on or after January 1, 2010.

ANALYSIS: Under current North Carolina law, an employer is required to deduct and withhold from an employee's wages the State income taxes payable by the employee on those wages and deposit the withheld taxes with the Department of Revenue. A person who pays more than $1,500 during a calendar year as compensation other than wages for personal services performed in this State by a nonresident individual or entity must withhold 4% of the

[84] The following counties require transfer affidavits: Camden, Chowan, Currituck, Dare, Martin, and Pasquotank.

payment and remit the withheld taxes to the Department.[85] This act applies the same withholding requirement to compensation other than wages paid to an ITIN holder. An ITIN is issued to a person who is required to have a taxpayer identification number but is not eligible to obtain a social security number. A person may obtain a social security number if the person has been lawfully admitted to the United States for permanent residence or under other immigration categories that authorize employment in the United States.

A payer required to withhold taxes from compensation paid to an ITIN holder must file a return and pay the withheld taxes to the Department. The withheld taxes are payable quarterly, monthly, or semiweekly depending upon the average amount withheld by a payer each month. If the amounts withheld average less than $250 a month, the payments are due quarterly. If the amounts withheld average at least $250 but less than $2,000, the payments are due monthly. All other payments are due by the date set under the Internal Revenue Code for payment of federal employment taxes attributable to the same wages. A payer who withholds taxes from compensation paid to an ITIN holder must give the person a written statement by January 31 following the end of the calendar year that sets out the total amount of compensation paid during the calendar year to the person and the total amount deducted and withheld.

The Department of Revenue requested this change in the law to better enable it to collect State income taxes on amounts paid to ITIN holders who are not employees. The Department reviewed 1099 Forms available through the Federal Data Exchange Program with the Internal Revenue Service. A review of the data indicated a number of North Carolina ITIN holders as the recipients of 1099 miscellaneous payments. Often, the ITIN holder receiving the compensation identified on the 1099 forms were illegal immigrants. Attempted collections of these amounts by the Department resulted in less than 10% of the amount of tax due. The Department believes that a withholding requirement on non-employee compensation paid to ITIN holders will insure the tax is properly paid on income earned in the State. The withholding requirement applies to an array of businesses, but one of the predominant ones is construction.

COMMUNITY LAND TRUST PROPERTY TAXATION.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-481	**HB 1586**	**Rep. Luebke, Hall**

AN ACT TO CLARIFY THE VALUATION OF COMMUNITY LAND TRUST PROPERTY.

OVERVIEW: This act classifies community land trust (CLT) property as a special class of property and requires resale restrictions to be considered in determining the property tax value.

FISCAL IMPACT: This act will lower the value of land trust property for property tax purposes, potentially lowering the revenues of the cities and counties in which the properties reside. There are currently two qualifying community land trusts active in North Carolina: Durham Community Land Trust, and Orange Community Housing and Land Trust. The changes in this bill will result in a $6,885.15 revenue loss for Durham County beginning in FY 2009-10 and a $5,250.64 revenue loss for the City of Durham beginning in FY 2009-10. The Orange County Board of

[85] The withheld taxes are credited to the employee or to the nonresident individual or entity from whom they were withheld. People from whom taxes have been withheld receive credit for the withheld taxes by filing a North Carolina income tax return, and any excess is refunded to the taxpayer.

Equalization and Review is currently conducting a hearing regarding land trust property. Depending on how the Board rules, there could be an additional revenue loss to Orange County, the City of Carrboro, the City of Chapel Hill, and the Carrboro-Chapel Hill School District.

EFFECTIVE DATE: This act is effective for taxable years beginning on or after July 1, 2010.

ANALYSIS: CLT property is a model of home ownership for low- and moderate-income families where the underlying land is owned by a nonprofit and the homes located thereon are owned (or rented for sufficiently long periods that banks treat the leasehold interest as an ownership interest for loan purposes) by the low- or moderate-income individuals or families. Notably, CLT property is subject to restrictions on the sales price in order to ensure the properties are affordable for future, subsequent low- and moderate-income families.

Under North Carolina law, real property must be appraised at its true value, or the value a willing, able, and knowledgeable buyer would give to a willing, able, and knowledgeable seller for the property. In appraising true value, the assessor must "consider … any … factor that may affect its value." Anecdotal evidence suggested inconsistent treatment by counties of the resale restrictions on CLT property and whether those restrictions qualified as as a "factor that may affect [a property's] value" for purposes of establishing a property tax value. Accordingly, some CLT properties were appraised at market value for tax purposes despite resale restrictions that disallowed the homeowner to sell the property at market value.

This act classifies CLT property for special property tax valuation and establishes how resale restrictions should be used by an assessor in establishing property tax values for this type of property. [86] CLT property is an improvement to real property that meets all of the following requirements:

- It is developed by a non-profit 501(c)(3) tax-exempt entity, which retains an interest in the property according to one of the following two models:
    - The improvement is conveyed to the qualifying owner and the land on which the improvement is constructed is leased to the qualifying owner under a 99-year lease, renewable for an additional 99-year term.
    - The improvement and the land on which the improvement is constructed are leased to the qualifying owner under a 99-year lease, renewable for an additional 99-year term.
- An interest in the property is conveyed to a North Carolina resident who occupies the improvement, as owner or lessee, as a permanent residence and who is part of a household with an annual income, at the time of transfer and adjusted for family size, of not more than 100% of the local area median income.
- Its resale value is governed by restrictions contained in the ground lease to ensure low-priced housing to subsequent qualifying owners.

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[86] This act is not the only preferential tax treatment provided for low-income housing. Last session, the General Assembly enacted S.L. 2008-146, which classified certain low-income rental housing developments as a special class of property for which the value must be assessed by using the income approach to valuation. For such property, the tax assessor must take into account any applicable rent restrictions and may not include any federal tax credits for affordable housing in determining income. The property value determination is limited to actual rental income as opposed to the rental income similarly situated property not subject to rent restrictions would be able to generate as income.

The tax value of CLT property when the property first qualifies for this classification is equal to the actual sales price of the house to the qualifying owner, minus any silent mortgage amount. In subsequent revaluations, the tax value of CLT property is capped at the original sales price plus the amount of capital gain the qualifying owner could realize from the sale.

Under G.S. 105-278.6(e), real property held by a nonprofit organization as a future site for housing for individuals or families with low or moderate incomes qualified for a deferral of property taxes. Those taxes become due and payable if homes for low or moderate income families are not built on the land within five years. In addition to classifying CLT property as a special class of property for property tax purposes, the act also modifies G.S. 105-278.6(e) in order to provide that eligibility for the tax deferral program does not end in situations such as bankruptcy or foreclosure, where the qualifying owner's interest is re-acquired by the CLT and the CLT owns the property, in toto, during the listing period.

DEVELOPMENT TIER DESIGNATION EXCEPTION.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-505	**HB 1500**	**Representative Spear**

AN ACT TO CREATE A NEW DEVELOPMENT TIER DESIGNATION EXCEPTION FOR CERTAIN SEAFOOD INDUSTRIAL PARKS.

OVERVIEW: This act provides that any seafood industrial park has a development tier one designation for purposes of economic development programs, including certain tax credits.

FISCAL IMPACT: There is a potential fiscal impact depending on whether and how many new parks are established, but no estimate is currently available. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2009 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective when the Governor signed it into law on August 26, 2009, and expires on July 1, 2012.

ANALYSIS: This act provides that any seafood industrial park created under Article 23C of Chapter 113 of the General Statutes has a development tier one designation. The North Carolina Seafood Industrial Park Authority (Authority) is an eleven-member board with nine appointments by the Governor and two by the General Assembly. Among its purposes, the Authority is charged with creating jobs and economic growth in the seafood and other marine-related industries.

The tier designations assigned to counties each year by the Secretary of Commerce are designed to measure and rank how economically distressed each county is based on four factors:

- Average rate of unemployment
- Median household income
- Percentage growth in population
- Adjusted assessed property value per capita

Counties designated as tier one are the most economically distressed according to these factors, while counties designated as tier three are the least economically distressed. This tier system is

incorporated into various economic development programs, including the Article 3J Tax Credits, to encourage economic activity in the less prosperous areas of the State. The thresholds and credit amounts are more favorable for tier one counties. Under current law, there are exceptions to the tier ranking system in which entities may be given a tier designation different from the county in which they are located. An exemption already exists for an industrial park located in multiple jurisdictions. This act creates a new exception for seafood industrial parks.

Currently, the only Seafood Industrial Park created under Article 23C of Chapter 113 of the General Statutes is located in Wanchese, Dare County,[87] North Carolina. However, since this facility is has no more room for expansion, the Authority is seeking new locations to accommodate future growth and to promote job creation. Of the 26 potential sites in 11 counties that were considered, Perquimans[88] was identified as the number one site. In 2008, Perquimans County and the Authority indicated their intent to enter into a partnership for the development of a 70-acre marine park. The County anticipates that when the park is fully developed it will have over 20 businesses, including six boat builders, boat repair and maintenance, marine engine sales and service, boat sales, upholstery, and cabinet making, with approximately 400 employees, and will be the major economic development initiative within the County. The Authority is also considering the establishment of another seafood industrial park in Hyde County. The lower tier designation may enable seafood industrial parks to obtain more generous tax incentives and federal money that they may not otherwise be able to obtain.

SALES TAX INCENTIVES FOR FLIGHT SIMULATORS.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-511	**SB 1057**	**Senator Dorsett**

AN ACT TO EXPAND THE SALES TAX EXEMPTION FOR AIRCRAFT SIMULATORS.

OVERVIEW: This act extends the sales tax exemption for aircraft simulators to all aircraft simulators used for flight crew training and maintenance training.

FISCAL IMPACT: The act will reduce General Fund revenues by $1.9 million in fiscal years 2009-2010 and 2010-2011. The act will also reduce local revenues by $0.8 million in fiscal years 2009-2010 and 2010-2011. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2009 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act is effective October 1, 2009, and applies to sales made on or after that date.

ANALYSIS: In 1999, a sales tax reduction from 6% to 1% with an $80 cap was given to passenger air carriers for purchases of aircraft simulators for flight crew training used at the air carrier's hub. The tax reduction also applied to interstate air couriers.

In 2005, the sales tax reduction was repealed and a sales tax exemption was provided for certain items, including aircraft simulators for flight crew training, for sales to an interstate passenger air carrier for use at its hub.

This act exempts from sales and use tax the sales of all flight simulators used for flight crew training and maintenance training. The changes to the sales tax exemption were requested as

[87] At the time of this publication, Dare County is a tier two county.
[88] At the time of this publication, Perquimans is a tier two county.

part of a development project for the Piedmont Triad International Airport. The Project seeks to promote creation of a flight training hub in the area by extending the credit to all flight simulators.

JMAC MODIFICATIONS.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-520	**HB 884**	**Representative Cole**

AN ACT TO MODIFY THE REQUIREMENTS FOR A GRANT FROM THE JOB MAINTENANCE AND CAPITAL DEVELOPMENT FUND.

OVERVIEW: This act does three things:

- It modifies the investment and employment requirements for a business to qualify for a grant from the Job Maintenance and Capital Development Fund.
- It increases the total aggregate cost of all agreements entered into under the Fund from $60 million to $69 million.
- It increases the total annual cost of any one agreement from $4 million to $6 million.

FISCAL IMPACT: The total impact is $9 million, because it increases the maximum payout from $60 million to $69 million from the Job Maintenance and Capital Development Fund. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2009 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The act becomes effective July 1, 2010.[89]

ANALYSIS: The General Assembly created the Job Maintenance and Capital Development Fund in 2007 as a non-reverting account in the Department of Commerce.[90] The Fund is similar to the Job Development and Investment Grant Fund created by the General Assembly in 2002, except that the purpose of the Job Maintenance and Capital Development Fund is to maintain jobs while the purpose of the Job Development Grant Program is to create new jobs. In September 2008, two companies each received a 10-year grant from the Job Maintenance and Capital Development Fund for up to $30 million provided they meet job retention, investment, and other performance requirements: the Goodyear Tire and Rubber Company in Fayetteville and the Firestone North American Tire in Wilson.

The legislation enacted in 2007 set a minimum investment requirement of $200 million within five years and a minimum job retention requirement of 2,000 full-time employees or equivalent full-time contract employees.[91] Domtar[92] a company in Washington County in Plymouth, is a

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[89] Senate Bill 825 initially contained the contents of this act. That bill failed third reading in the House on August 6, 2009. The contents of the bill were put into House Bill 884. House Bill 884 changed the effective date to July 1, 2010. Under Senate Bill 825, the bill would have become effective when it became law.

[90] S. L. 2007-552, G.S. 143B-437.11; S. L. 2008-187 recodified the statute as G.S. 143B-437.012.

[91] Under its agreements, Goodyear must retain 2, 398 workers and invest $200 million by 2012 at its Fayetteville facility and Firestone must retain 2,083 workers and invest $200 million by 2010 at its Wilson facility.

[92] Domtar was originally part of Weyerhauser.

manufacturing company converting from paper production to fluff production.[93] The cost of the modernization project is expected to be $69 million. It is anticipated that the modernization project will ensure the future of the mill, but it will reduce the number of full-time equivalent employees from 520 to 320. This company could not meet the minimum investment and job retention requirements needed to receive a grant from the Job Maintenance and Capital Development Fund. This act creates a different level of investment and job retention for a manufacturing business that is converting its manufacturing process to change the product it produces:

- It reduces the minimum investment requirement from $200 million to $65 million. A business must make this investment with private funds and the investment must be made within three years of the time the investment commences.
- It reduces the minimum job retention requirement from 2,000 full-time employees or contract employees to 320 full-time employees. The business must maintain this level of employment for the full term of the grant.

The Department may not enter more than five agreements, and this act does not change that limitation. However, the act does increase the total aggregate cost of all agreements for grants from the Fund from $60 million to $69 million and it increases the annual cost of any one agreement from $4 million to $6 million. A grant agreement obligates the State to make a series of grant payments over a period of time, but it does not authorize the taxing power of the State to be pledged.

The act does not change any of the other following conditions a business must meet to qualify for a grant from the Job Maintenance and Capital Development Fund:

- The project must be located in a development tier one at the time the grant application is made.
- All newly hired employees of the business must be citizens of the United States or have proper identification and documentation of their authorization to reside and work in the United States.
- The business must pay an average weekly wage that is at least equal to 140% of the average wage for all insured private employers in the county.
- The business must make health insurance available for all full-time employees and equivalent full time contract employees of the project for which the grant application is made. This health insurance must pay at least 50% of the premiums for health care coverage that equals or exceeds the minimum provisions of the basic health care plan of coverage under G.S. 58-50-125. The business must provide a certification to the Department showing continuing compliance annually.
- The business, with respect to the location for which the grant is made, has no citations under OSHA that have become a final order within the past three years for willful serious violations or for failing to abate serious violations.
- The business, with respect to the location for which the grant is made, has no pending administrative, civil, or criminal enforcement action based on alleged significant violations of any program implemented by DENR, and has had no final determination

[93] Fluff is created from loblolly pine and is used in disposable diapers for children and adults.

of responsibility for any significant administrative, civil, or criminal violation of any program implemented by an agency of DENR within the past three years.

Any business meeting the requirements for a grant from the Job Maintenance and Capital Development Fund may apply for a grant. The Department of Commerce is charged with the responsibility of administering the selection of projects receiving a grant. The Department submits the project applications that it deems eligible and appropriate for a grant to the Economic Investment Committee. The Economic Investment Committee must make the following findings before it can recommend a project receive a grant from the Fund:

- The conditions for eligibility have been met.
- A grant from the Fund for the project is necessary to carry out the public purposes of the Fund.[94]
- The project is consistent with the economic development goals of the State and the area where the project is located.
- Affected local governments have participated in retaining the business and offered incentives appropriate to the project.
- A grant is necessary for the maintenance of the project within the State.

The Economic Investment Committee must recommend the appropriate grant amount for each applicant to whom it believes a grant should be given. The Committee may consider the following factors in determining the amount of the grant:

- 95% of the privilege and sales and use taxes paid by the business on machinery and equipment installed at the project that is the subject of the agreement.
- 95% of the sales and use taxes paid by the business on building materials used to construct, renovate, or repair facilities at the project that is the subject of the agreement.
- 95% of the additional income and franchise taxes that are not offset by tax credits.
- 95% of the taxes paid on electricity, piped natural gas, and other fuel that is consumed at the project that is the subject of the agreement.
- 100% of worker training expenses associated with the project that is the subject of the agreement.
- 100% of any State permitting fees associated with the capital expansion at the project that is the subject of the agreement.

Absent a determination by the Secretary of Commerce that a project is no longer eligible or appropriate to receive a grant, the Department must enter into a binding and continuing contract, not to exceed 10 years, on behalf of the State with the business to provide a grant or series of grants for each project recommended by the Committee. The grant agreement must contain the following:

[94] The public purposes include stimulating economic activity, maintaining high-paying jobs in the State, encouraging capital investment, reducing economic distress, enlarging the tax base, increasing revenue to the State's political subdivisions, and maintaining continued diversity in the State's industrial base.

- All performance criteria, remedies, and other safeguards recommended by the Committee or required by the Department to secure the State's investment.
- A provision prohibiting a recipient business from receiving a payment or benefit under the agreement when it has received a notice of an overdue tax debt that has not been satisfied or resolved.

In order to ensure that public funds are used only for the Fund's public purposes, to protect the State's investment, and to ensure that the projected benefits of the project result, the Department must require each recipient business to agree to meet performance criteria, including maintenance of an appropriate level of employment at specific compensation levels, maintenance of health insurance for all full-time employees, investment of a specified amount over the agreement term, and any other criteria considered appropriate by the Department. In addition, the agreement must require the business to repay or reimburse an appropriate portion of the grant for any failure to meet the performance criteria.

The Department is charged with monitoring compliance by a recipient business with performance criteria and with administering repayment for failure by a recipient business to meet performance criteria. The Department pays for the administrative costs for these responsibilities from funds appropriated for that purpose or other economic development purposes. Within two months after the end of each calendar quarter, the Department must report to the Joint Legislative Commission on Governmental Operations regarding the Fund, including a listing of each grant awarded and each agreement entered into during the preceding quarter, and detailed information about any defaults and repayment during the preceding quarter. For each grant agreement in the report, the Department must include the name of the business, the cost-benefit analysis by the Committee, a project description, and the projected grant amount to be paid during the current fiscal year. The Department must publish its report on its website and make printed copies available upon request.

REVOLVING LOAN FUND FOR ENERGY IMPROVEMENTS.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-522	**HB 1389**	**Rep. Fisher, Harrison, Rapp**

AN ACT TO AUTHORIZE CITIES AND COUNTIES TO ESTABLISH LOAN PROGRAMS TO FINANCE THE INSTALLATION OF DISTRIBUTED GENERATION RENEWABLE ENERGY SOURCES OR ENERGY EFFICIENCY IMPROVEMENTS THAT ARE PERMANENTLY AFFIXED TO REAL PROPERTY.

OVERVIEW: This act authorizes cities and counties to establish revolving loan programs to finance energy efficiency improvements and distributed generation renewable energy sources that are permanently affixed to real property.

FISCAL IMPACT: This act has no impact on General Fund revenues. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2009 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective when signed into law by the Governor on August 26, 2009.

ANALYSIS: North Carolina cities and counties are eligible to obtain federal grant funds under the American Recovery and Reinvestment Act of 2009, P.L. 111-5 (ARRA), during the 2009-2011 biennium to finance certain energy-related programs. The Energy Efficiency Conservation Block Grants Program (EECBG) seeks to assist eligible entities to reduce fossil fuel emissions, to reduce total energy use, and to improve energy efficiency in transportation and buildings.

This act authorizes cities and counties to establish loan programs to finance energy efficiency improvements and the installation of distributed renewable energy sources that are permanently affixed to real property. Cities and counties may use EECBG funds and any other restricted funds the entity may have. The term of the loan may not be greater than 15 years, and the annual interest rate charged on the loan may not exceed 8%.

The term 'renewable energy source' has the same meaning as renewable energy resource as defined in G.S. 62-133.8. That definition does not include peat, a fossil fuel, or nuclear energy resource but does include all of the following:

- Solar electric.
- Solar thermal.
- Wind.
- Hydropower.
- Geothermal.
- Ocean current or wave energy resource.
- Biomass resource, including agricultural waste, animal waste, wood waste, spent pulping liquors, combustible residues, combustible liquids, combustible gases, energy crops, or landfill methane.
- Waste heat derived from a renewable energy resource and used to produce electricity or useful, measurable thermal energy at a retail electric customer's facility.
- Hydrogen derived from a renewable energy resource.

IDF CHANGES/RESEARCH & PROD. SERV. DISTRICTS.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-523	**HB 1514**	**Rep. Crawford, Dickson, Gibson**

AN ACT TO EXPAND ECONOMICALLY DISTRESSED COUNTIES TO INCLUDE ALL TIER ONE AND TIER TWO COUNTIES, TO INCREASE THE MAXIMUM EXPENDITURE OF FUNDS FROM THE INDUSTRIAL DEVELOPMENT FUND, TO EXEMPT FROM RULE MAKING THE CUSTOMIZED TRAINING PROGRAM UNDER THE COMMUNITY COLLEGE SYSTEM, AND TO AMEND THE COUNTY SERVICE DISTRICT ACT OF 1973 TO ALLOW ADDITIONAL COUNTY RESEARCH AND PRODUCTION SERVICE DISTRICTS.

OVERVIEW: This act expands the use of the Industrial Development Fund (IDF) and temporarily authorizes the establishment of additional county research and production service

districts. The remainder of this act does not affect North Carolina tax laws and is not discussed below.

FISCAL IMPACT: No fiscal impact.

EFFECTIVE DATE: This act became effective when the Governor signed it into law on August 26, 2009. The modification of the qualification of counties for IDF benefits expires in three years on July 1, 2012.

ANALYSIS: The IDF provides funds to assist local governments of the most economically distressed counties in the State in creating jobs in eligible industries. An economically distressed county is a county that has one of the 65 highest rankings under the development tier designation. An 'eligible industry' is defined as a company or person engaged in the business of air courier services, information technology and services, manufacturing, or warehousing and wholesale trade. The IDF funds must be used for (i) installation of or purchases of equipment for eligible industries; (ii) structural repairs and renovations of buildings for expansion of eligible industries; or (iii) construction of or improvements to new or existing utility lines or equipment or transportation infrastructure for existing or new building for the eligible industries. The funds must be used by the city and county governments for projects that directly result in the creation of new jobs and must be expended at a maximum rate of $5,000 per new job created up to a maximum of $500,000 per project.

Within the IDF there is a special account entitled the Utility Account that provides funds to assist the local government units of economically distressed counties. The funds in the Utility Account may only be used for the construction of or improvements to new or existing water, sewer, gas, telecommunications, high-speed broadband, electrical utility distribution lines or equipment, or transportation infrastructure for existing or new or proposed industrial buildings to be used for eligible industrial operations. There is no maximum funding amount per new job to be created or per project under the Utility Account.

Under the development tier designation, the 40 most distressed counties are designated as tier one, the next 40 as tier two, and the 20 least distressed as tier three.

This act makes the following changes related to the IDF:

- Increases the maximum rate by which funds in the IDF are to be expended for jobs from $5,000 to $10,000.
- Authorizes funds from the IDF to be spent for job retention as well as job creation.
- Expands the definition of "economically distressed county" to a county that is a tier one or a tier two county, which consists of the top 80 counties. Prior law defined the term as a county that has one of the 65 highest rankings.
- Provides funds from the Utility Account to tier one or tier two counties instead of only to counties with one of the 65 highest rankings under the development tier designation.

This act also authorizes additional county research and production service districts. Under current law, a board of commissioners may, by resolution, establish a research and production district for any area of the county if it meets the standards listed below. A county may levy property taxes within the district in addition to those levied throughout the county with a cap of 10¢ on each $100 value of property.

This act modifies those standards to allow for the creation of such a district when all of the real property in the district is part of a multijurisdictional industrial park. The maximum property tax rate for a district meeting those criteria would be 15¢ on each $100 value of taxable property.

The current standards for a research and production service district are:

1. All real property in the district is being used for or is subject to covenants that limit its use to research or scientifically-oriented production or for associated commercial or institutional purposes.
2. The district contains at least 4,000 acres.
3. The district includes research and production facilities that in combination employ at least 5,000 persons.
4. All real property located in the district was at one time or is currently owned by a nonprofit corporation, which developed or is developing the property as a research and production park.
5. A petition requesting creation of the district signed by at least fifty percent (50%) of the owners of real property in the district who own at least fifty percent (50%) of total area of the real property in the district has been presented to the board of commissioners. In determining the total area of real property in the district and the number of owners of real property, there shall be excluded (1) real property exempted from taxation and real property classified and excluded from taxation and (2) the owners of such exempted or classified and excluded property.
6. The district has no more than 25 permanent residents.
7. There exists in the district an association of owners and tenants, to which at least seventy-five percent (75%) of the owners of real property belong, which association can make the recommendations provided for in G.S. 153A-313.
8. There exist deed-imposed conditions, covenants, restrictions, and reservations that apply to all real property in the district other than property owned by the federal government.
9. No part of the district lies within the boundaries of any incorporated city or town.

DEVELOPMENT TIER EXCEPTION MODIFICATION.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-524	**SB 898**	**Senator Soles**

AN ACT TO MODIFY THE EXCEPTION FOR TWO-COUNTY INDUSTRIAL PARKS FOR DEVELOPMENT TIER DESIGNATION PURPOSES.

OVERVIEW: This act reduces the percentage of a two-county industrial park that must be located in the lower tier county to qualify the park for the lower development tier designation.

FISCAL IMPACT: There is a potential fiscal impact to the extent this act expands the scope of eligibility for certain tax credits and other incentives. However, since the Article 3J credits sunset January 1, 2011, it is not known whether any jobs or investment will take place in time for credits to be taken under the act. According to the Department of Commerce and the Columbus County Economic Development Commission, the process of purchasing the land,

developing infrastructure and recruiting businesses for the proposed industrial park will take several years. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2009 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective when the Governor signed it into law on August 26, 2009, and expires on July 1, 2012.

ANALYSIS: This act modifies in two ways the standards that must be met in order for a two-county industrial park to qualify for the tier designation of the lower-tiered county. First, it reduces from one-third to one-fifth, the percentage of property of an industrial park located in two counties that must be located in the lower-tiered county in order to be eligible for the lower tier designation. Second, the counties must have entered into an interlocal agreement providing that the incremental increase in property tax revenues within the park shall be shared equally by the counties.

The Department of Commerce annually ranks the State's 100 counties based on economic well-being and assigns a tier designation to each county. This tier system is incorporated into various State incentive programs to encourage economic activity in the less prosperous areas of the State. The 40 most distressed counties are designated tier one, the next 40 are designated tier two, and the remaining 20 counties are designated tier three. A development tier designation is effective only for the calendar year following the designation.

The ranking system is based upon a county's development factor[95] and statutorily mandated adjustments. One of the statutorily mandated adjustments[96] is for a two-county industrial park. An eligible two-county industrial park has the lower development tier designation of the two counties in which it is located. Prior to this act, an eligible two-county industrial park had to meet all of the following conditions:

- It is located in two contiguous counties.
- At least 1/3 of the park is located in the county with the lower tier designation.
- 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.
- 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.

Columbus and Brunswick Counties could benefit from this legislation. They are building a two-county industrial park and desire to take advantage of the lower tier designation of Columbus County. Columbus County is a tier one county and Brunswick County is a tier three county. The two counties are planning to develop the "International Logistics Park of North Carolina." This industrial park would be the first at-port distribution center in North Carolina. The 1000-acre park will be located along Highway 74 (future I-74) and within 16 miles of the Port of Wilmington. The park would house a series of large distribution centers from which goods coming into the State Port at Wilmington could be distributed to retail outlets or regional

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[95] A county's development factor is the sum of the county's rank in the following areas: average rate of unemployment for the most recent 12-month period, median household income for the most recent 12-month period, percentage growth in population for the most recent 36 months, and adjusted assessed property value per capita for the most recent taxable year.

[96] Other statutorily mandated adjustments include those for small counties, development tier one areas, and multijurisdictional industrial parks.

distribution centers. The ports located in Charleston, SC, Norfolk, VA, and Savannah, GA all have at-port distribution centers located near them.

The International Logistics Park will straddle the Brunswick and Columbus County line with approximately 200 acres located in Columbus County and the remaining 800 acres or so located in Brunswick County. Prior to the act, the park could not exceed 600 acres to qualify for the adjustment, since at least one-third of the park (200 acres) would need to be in the lower tier area. Under the act, the entire 800 acres could qualify for the adjustment because more than one-fifth of the park (160 acres) would be located in the tier one county.

The counties anticipate that the park will create 4000 new jobs for the area and generate at least $300 million in private investments. The lower tier designation will allow businesses locating in the International Logistics Park to qualify for the larger tax credits available under Article 3J for tier one counties and other incentives available to tier one counties. Those incentives include:

- Credit for creating jobs. – The job threshold and the credit amount per job are determined by the tier designation of the county in which the jobs are created. For a tier one county, the minimum number of jobs that must be created is five and the credit amount per job is $12,500; for a tier two county, the minimum number of jobs is 10 and the credit amount per job is $5,000; for a tier three county, the minimum is 15 and the credit amount is $500.
- Credit for investing in business property. – The credit percentage and threshold are based on the tier designation of the county where the property is placed in service. For a tier one county, there is no threshold and the credit percentage is 7% of the cost of capitalized tangible personal property; for a tier two county, the threshold is $1 million and the credit percentage is 5%; for a tier three county, the threshold is $2 million and the credit percentage is 3.5%.
- Credit for investing in real property. – This credit is only available for an eligible establishment located in a tier one county. To be eligible, the taxpayer must invest at least $100 million in real property within a three-year period and create at least 200 new jobs within two years.
- Credit for research and development. – The credit for expenses for research performed in a tier one county is 3.25% of the expenses, regardless of the amount of expenses incurred. For research performed in a tier two or tier three county, the percentage varies depending upon the amount of expense occurred.
- Job development investment grant. – This discretionary incentive program provides a limited number of cash grants directly to new and expanding businesses. The grants are based on job creation and investment commitment. The minimum number of jobs that must be created to qualify for a grant varies depending upon the development tier designation of the county where the jobs are created: the minimum number of jobs that must be created in a tier one county is 10 and for all other counties the minimum number of jobs that must be created is 20.
- Industrial development fund. – This fund provides grants and loans for infrastructure development in the 66 most distressed counties. There is no local match requirement in the 26 most distressed counties.

CRITICAL INFRASTRUCTURE ASSM'T CHANGES.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-525	**SB 97**	**Senator Hartsell**

AN ACT TO ALIGN THE AUTHORIZED PURPOSES FOR SPECIAL ASSESSMENTS FOR CRITICAL INFRASTRUCTURE NEEDS WITH THE PURPOSES OF PROJECT DEVELOPMENT FINANCING; TO ADD RENEWABLE ENERGY SOURCES AND ENERGY EFFICIENCY IMPROVEMENTS AS PURPOSES; TO CLARIFY THE LAW CONCERNING FINANCING A PROJECT FOR WHICH ASSESSMENTS MAY BE PLEDGED, TO EXEMPT PRIVATE ENTITIES THAT IMPLEMENT CERTAIN PROJECTS FOR WHICH ASSESSMENTS MAY BE PLEDGED FROM THE COMPETITIVE BIDDING REQUIREMENTS OF LOCAL GOVERNMENTS; AND TO PROVIDE GUIDANCE FOR LOCAL GOVERNMENTS WHEN ISSUING CERTAIN DEBT INSTRUMENTS AND ENTERING INTO CERTAIN AGREEMENTS.

OVERVIEW: This act does all of the following:

- Aligns the purposes for which cities and counties may issue bonds payable from special assessments with the purposes for which project development financing may be used and adds the financing of renewable energy sources and energy efficiency improvements as a purpose for which bonds payable from special assessments may be used.
- Allows a city or county to partner with a private entity to construct a project financed with assessment-based financing.
- Clarifies that a city or county may use one or more financing sources to pay the costs of a project for which a special assessment is imposed and provides that assessments may be used to secure revenue bonds or as additional security for a project development financing debt instrument.
- Provides budgeting guidance to local governments in meeting future project development debt obligations.

FISCAL IMPACT: No fiscal impact. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2009 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective when the Governor signed it into law on August 26, 2009.

ANALYSIS: Cities and counties use project development financing and special assessments to help finance the cost of long-term capital projects related to economic development projects. The subject of the development typically bears the cost of these financing tools. In the case of project development financing, the source is new property tax revenues generated by the development and in the case of special assessments, the source is assessments imposed on the property by its owner to fund the costs of infrastructure that will benefit that property. These tools are relatively new in North Carolina.[97] In other areas of the country that have these financing tools, they are frequently used together.

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[97] S.L. 2003-403 authorized cities and counties to use project development financing, Article 6 of Chapter 159. S.L. 2008-165 authorized cities and counties to use special assessments, Article 9A of Chapter 153A (counties) and Article 10A Chapter 160A (cities).

This act modifies these two financing tools to make them more compatible. The act aligns the purposes for which cities and counties may issue bonds payable from special assessments with the purposes for which project development financing may be used under G.S. 159-103. Assessment-based financing may currently be used for water and sewer systems, stormwater systems, public transportation facilities, school facilities, and streets and sidewalks. This change effectively expands the purposes for which assessment-based financing may be used to include the following:

- Airport facilities
- Hospital facilities
- Art galleries, museums, and art centers
- Industrial parks
- Community college facilities
- Improving existing telephone systems
- Parks and recreation facilities
- Auditoriums, coliseums, arenas, stadiums, civic centers, and convention centers
- Parking facilities
- Preservation of railroad corridors
- Low and moderate income housing
- Gas systems
- Electric systems

The act also adds as a purpose for which assessment-based financing may be used the installation of distributed generation renewable energy sources or energy efficiency improvements that are permanently fixed to commercial, industrial, or other real property.[98]

The State Treasurer's office expressed concern about the use of assessments to finance traditional government functions, such as community college facilities and museums. Assessments may only be imposed on property that benefits from a project in some special way that is different from other property that is not assessed. Generally, these types of projects do not provide the kind of special benefit that warrants imposition of an assessment. There may be unusual circumstances where a special benefit could be substantiated, but these circumstances would be exceptional. Before assessment-based financing could be imposed for any of these purposes, the Local Government Commission must approve the proposed revenue bond issuance and one of the conditions that must be met before the Commission may approve such a debt issuance is that the proposed assessment is adequate and not excessive.

The act allows a city or county to implement a project financed in whole or in part by the imposition of assessment-based financing through contracts with public or private entities. The addition of this provision provides flexibility in procurement and greater conformity with project development financing projects. The provision recognizes that many of the local infrastructure projects associated with assessment-based financing are part of a unified and comprehensive development plan that makes it practical to construct a number of projects together.

The State Treasurer's office also expressed concern that the provision allows a local unit to partner with a private entity and bypass the bidding rules of Article 8 of Chapter 143 of the General Statutes. To address this concern, the act provides that private entities that undertake these projects are not subject to the competitive bidding requirements so long as no more than 25% of the estimated cost of the project is funded by general obligation bonds or general revenue. The act also provides that if the project is on public property and the bidding rules do not apply to the construction on this property, then the county must obtain certification from the private developer to ensure that claims for payment by contractors of the funds derived from

[98] The House Judiciary Committee adopted an amendment to add this purpose.

the public financing will be met. The certification must be in the form and in an amount acceptable to the city or county. If the entity responsible for disbursing these funds receives notice of a claim from a person who would be entitled to a mechanic's or materialman's lien but for the fact that the claim relates to work performed on or supplies provided to publicly owned property, then either no disbursement of funds may be made until the claim is resolved or funds in an amount necessary to satisfy the claim must be set aside until the claim is resolved.

The act revises the financing provisions to address an interpretation issue raised by the School of Government and to provide that special assessments may be used to secure other obligations, including project development financing debt instruments. The act clarifies that the costs of these projects may be covered by using any combination of the following financing sources:

- Revenue bonds issued under G.S. 153A-210.6.
- Project development financing debt instruments issued under the North Carolina Project Development Financing Act, Article 6 of Chapter 159 of the General Statutes.
- General obligation bonds issued under the Local Government Bond Act, Article 4 of Chapter 159 of the General Statutes.
- General revenues.

The act also provides that special assessments may be pledged as additional security for project development financing debt instruments as well as revenue bond financing debt instruments. If the assessment is pledged to secure financing, the city or county must covenant to enforce the payment of assessments.

Lastly, the act provides three methods for a city or county to provide additional credit support to project development debt obligations. A city or county that issues project development financing debt instruments may agree in the proceedings relating to the issuance, and in the agreements it enters into with property owners in the development financing district,[99] that it will include in its budget an appropriation of the amount due on the debt instrument. A second method is to include in its appropriations the amount necessary to restore the level of funding in a reserve fund to its required level. The third option available is to permit a city or county to use any excess revenues in its general fund to make the required payments.[100] A local unit of government that provides this agreement in its finance-related proceedings or in its increment agreement with property owners must expressly state that the agreement does not create an obligation on the governing board to make the appropriation; the appropriation continues to be subject to the annual budget making process.

CONGESTION RELIEF/INTERMODAL TRANSPORT FUND.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-527	**HB 148**	**Rep. Carney, Allen, Ross, McGee**

[99] See G.S. 159-108.
[100] See G.S. 159-107.

AN ACT TO ESTABLISH A CONGESTION RELIEF AND INTERMODAL TRANSPORTATION 21ST CENTURY FUND; TO PROVIDE FOR ALLOCATION OF THOSE FUNDS TO: (1) LOCAL GOVERNMENTS AND TRANSPORTATION AUTHORITIES FOR PUBLIC TRANSPORTATION PURPOSES, (2) SHORT-LINE RAILROADS, FOR ASSISTANCE IN MAINTAINING AND EXPANDING FREIGHT SERVICE STATEWIDE, (3) RAILROADS FOR INTERMODAL FACILITIES, MULTIMODAL FACILITIES, AND INLAND PORTS, (4) MAKE CAPITAL IMPROVEMENTS ON RAIL LINES TO ALLOW IMPROVED FREIGHT SERVICE TO THE PORTS AND MILITARY INSTALLATIONS, (5) EXPAND INTERCITY PASSENGER RAIL SERVICE; TO EXTEND LEVELS OF LOCAL TRANSIT FUNDING AUTHORIZATION TO THREE URBAN REGIONS; AND TO ALLOW OTHER LOCAL GOVERNMENTS OPTIONS FOR LOCAL TRANSIT FUNDING.

OVERVIEW: This act, which was a recommendation of the 21st Century Transportation Committee, does several things designed to provide funding options to improve public transportation and to relieve transportation-related congestion, including:

- Establish a fund to provide grants for public transportation, railroads for Intermodal and multimodal facilities and inland ports, State ports for terminal railroads and improved access to military facilities, and expansion of intercity passenger rail service.
- Authorize certain transportation authorities to levy, with voter approval, a ½% local sales tax to be used only for transportation systems.
- Authorize other counties that operate a public transportation system or have a municipality in the county that operates a public transportation system to levy, with voter approval, a ¼% local sales tax to be used only for public transportation systems.
- Authorize an increase in local vehicle registration taxes.

FISCAL IMPACT: The additional ½% sales tax would generate an estimated $72.7 million for the Triangle Transit Authority, which includes Wake, Durham, and Orange Counties, and $46.6 million for the Piedmont Authority for Regional Transportation (PART), which includes Forsyth and Guilford Counties. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2009 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective when the Governor signed it into law on August 11, 2009.

ANALYSIS:

State Grant Program for Intermodal Transit – Section 1 of this act creates the Congestion Relief and Intermodal Transportation 21st Century Fund (Fund) and authorizes the Secretary of Transportation, after consultation with the Board of Transportation, to make grants from the Fund to the entities listed below. The amount of grant funding will depend on the appropriations authorized for the Fund. The 2009 Appropriations Act did not include any appropriations for this Fund. In all cases except for the expansion of intercity rail service, the applicant must provide matching funds in an amount at least equal to the grant amount. The eligible recipient entities are:

- Local governments and transportation authorities for public transportation. The grant requires (i) approval of the application by the Metropolitan Planning Organizations covering the applicant; and (ii) a transit plan covering various planning policies and housing needs. A grant may not exceed 25% of the project cost.

- Short line railroads to assist in economic development and access to ports and military installations. A grant may not exceed 50% of the project cost. The total amount of annual grants for this purpose is limited to $5 million.
- Railroads to assist in rail improvements, intermodal or multimodal facilities or restorations to (i) serve ports, military installations, inland ports or (ii) improve rail infrastructure to reduce or mitigate truck traffic on the highway system. A grant may not exceed 50% of the project cost. The total amount of annual grants is limited to $10 million.
- State ports for terminal railroads and improved access to military facilities and Intermodal or multimodal facilities. A grant cannot exceed 50% of project cost. The total amount of annual grants is limited to $10 million.
- Expansion of intercity passenger rail service.

Sales Tax Authorization. – Section 2 of this act authorizes transportation authorities and counties that operate a public transportation system or have a municipality in that county that operates a public transportation system to levy additional sales and use tax for public transportation purposes. The rate of tax varies as described below. This part also allows special districts that levy a sales tax to receive an annual refund of sales and use tax paid by the district.

- Mecklenburg – In 1997, Mecklenburg County was authorized to levy an additional ½% sales and use tax for the purpose of funding public transportation needs. Under this act, there is no change from current law, except that funds can be used for bicycle and pedestrian infrastructure that supports public transportation.
- Triangle and Triad – A ½% sales tax may be levied in one or more of Durham, Orange and Wake Counties, which operate the Triangle Transit Authority (TTA), or in one or more of Forsyth and Guilford Counties, which operate the Triad's Piedmont Authority for Regional Transportation (PART), to be used only for public transportation.

To authorize the tax, the board of the TTA or PART, and the county board(s) of commissioners of the counties where the tax is to be levied must jointly agree to establish a special tax district and conduct a referendum. The date of the referendum is to be agreed on jointly by the transit authority board, the county board(s) of elections, and the county board(s) of commissioners.

If the tax is approved in all of the counties voting, the tax will apply in all of those counties. If the tax is approved in less than all of the counties voting, the tax may be levied in any county that approves it. If a particular county votes no, the tax cannot be levied in that county. After a successful referendum, the transit authority board may levy the tax.

A financial plan must be approved by the following entities, either before or after the referendum, but prior to the levy of the tax: (i) the transit authority board (ii) the board of commissioners of each county where the tax is to be levied, and (iii) all Metropolitan Planning Organizations whose jurisdiction includes any of the area of the special district.

The financial plan must provide for equitable use of the net proceeds within or to benefit the special district and consider (i) the identified needs of local public transportation systems in the district, (ii) human service transportation systems within the district, and (iii) expansion of public transportation systems to underserved areas of the district. The plan may be revised from time to time. An interlocal agreement between the transportation authority and all of the counties in the special district may require periodic review and approval of the financial plan.

The transit authority board will be the management agency for any multi-county district. The county board of commissioners is the management agency for any single county district, but may contract with the transit authority as needed for operation of the system.

If the district is approved in a referendum and does not consist of all three counties in the Triangle or both Triad counties, it may be expanded to include an additional county or counties by joint action of the transit authority and the board of commissioners of the county or counties to be added, with a favorable referendum in the county or counties to be added.

Repeal of the tax requires the approval of the transit authority and the county boards of commissioners of the counties involved and a referendum. A referendum on repeal can also be forced by a petition of 15% of the registered voters of the district.

- Remaining 94 counties – Section 2 authorizes the remaining 94 counties to levy a sales tax of ¼% with a referendum called by the county board of commissioners, but only if the county or a municipality within that county operates or contracts for the operation of a public transportation system and only if the county has levied the ¼-cent county sales tax authorized under Article 46 of Chapter 105 of the General Statutes. Funds may be used only for public transportation and are allocated between the county and the city under the same formula as for the increased vehicle registration fee set out in Section 4 of the act.

Local Vehicle Registration Charge Increase. – Since 1991, Triangle Transit has been authorized to levy a $5.00 vehicle registration tax, collected by DMV. This authorization was later extended to the Triad. The three Triangle counties are currently at the maximum. In the Triad, only Randolph County is levying the tax. Since legislative authorization in 1991, inflation brings the value of that $5.00 to $7.85. Section 3 of this act authorizes the tax to be increased to a maximum of $7.00, effective immediately and to $8.00, effective July 1, 2010. In the Triangle, a fee increase must be approved by the Triangle Transit Board, the boards of commissioners of all three counties, and by a special tax board consisting of two commissioners from each of the three counties, as provided by current law. In the Triad, the current fee authorization is on a county-by-county basis with the approval of the PART board and the board of commissioners of the county.

Additional Vehicle Registration Charge. – Section 4 of this act allows all counties in which there is a county or municipal transit system to levy a vehicle registration tax of up to $7.00. The tax will be collected by DMV, as is the current Triangle Transit registration fee. Within the levying county, the tax will be shared by the county and municipalities, with the county receiving funds based on the population in the unincorporated areas and the municipalities based on the population within the corporate limits. If the county does not operate a transit system, it does not get a share of the funds; likewise any municipality not operating a transit system does not get a share of the funds. Those funds will be reallocated to those entities within the county that do operate a transit system. The county or city does not have to operate the system directly. It may contract for operation with another county or city, regional transit agency, or private entity. Funding allocation for human services transportation operating countywide can be determined by interlocal agreement.

Vehicle Registration Tax Conformed to New Registration System Deadlines. – Section 5 of this act conforms the deadlines for changes to the regional authority registration taxes with the Division of Motor Vehicles combined registration/inspection renewal system by increasing the amount of notice the DMV receives before a change goes into effect.

Supplemental Property Tax. – Section 6 of the act authorizes a supplemental property tax in the Research Triangle Park special tax district. Under 1985 legislation, that district may levy a tax up to 10 cents on each $100 value of property for general municipal purposes. The act authorizes an additional 10 cents on each $100 value of property for public transportation with the RTP or to provide for public transportation from RTP to other public transportation systems or to other places outside RTP such as RDU airport. This language was agreed to by a special ballot of property owners in RTP prior to committee consideration of the legislation. Each one cent raises approximately $430,000 per year. The actual tax levy must be agreed upon each year by the special tax district advisory board and the Wake and Durham County Boards of Commissioners.

EXPAND FILM CREDIT.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-529	**SB 943**	**Senator Garrou**

AN ACT TO PROVIDE FOR AN ALTERNATIVE CREDIT FOR QUALIFYING EXPENSES OF A PRODUCTION COMPANY.

OVERVIEW: This act increases the income tax credit for a production company from 15% to 25% of the company's qualifying expenditures. However, in exchange for the higher credit amount, a taxpayer must subtract from the credit amount the difference between the amount of tax paid on purchases subject to the privilege tax on mill machinery under G.S. 105-187.51 and the amount of tax the company would have paid on those purchases if they had been subject to the combined general rate of sales tax under G.S. 105-164.4. A taxpayer may continue to claim the lower 15% credit amount without making this deduction.

FISCAL IMPACT: The act is expected to have minimal fiscal impact in fiscal year 2010-2011. The General Fund revenue loss in fiscal year 2011-2012 and future years is expected to be $40 to $60 million. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2009 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The act is effective for taxable years beginning on or after January 1, 2010, and applies to qualifying expenses incurred on or after that date.

ANALYSIS: In 2005, the General Assembly replaced the film industry development grant program with a refundable income tax credit equal to 15% of the qualifying expenses spent by a production company in connection with a production.[101] This act provides a production company with the choice of two different credit amounts. A taxpayer chooses which credit amount to claim when the taxpayer files the return claiming the credit. A taxpayer's election as to which credit amount to claim is binding. The two credit amounts are as follows:

- The current amount, which is equal to 15% of qualifying expenses. Qualifying expenses are the total amount spent in North Carolina on the following:
    - Goods and services leased or purchased by a production company in connection with a production.

[101] The incentive is targeted at feature films, episodic television series, and commercial advertising. The credit does not apply to the following: political advertising, television production of a news program or live sporting event, material that is obscene, or a radio production.

- Compensation and wages paid by a production company on which it remitted withholding payments to the Department of Revenue. An amount paid in excess of $1 million to an individual for compensation may not be included as a qualifying expense.
- Cost of production-related insurance coverage obtained on the production. Expenses for insurance and coverage purchased from a related member may not be included as a qualifying expense.

- An alternative amount, which is equal to 25% of qualifying expenses, less the difference between the amount of tax paid on purchases subject to the privilege tax on mill machinery under G.S. 105-187.51 and the amount of tax the company would have paid on those purchases if they had been subject to the combined general rate of sales tax under G.S. 105-164.4.[102]

The term 'mill machinery' is not defined. The Department of Revenue has long interpreted the term to include cameras, film, and props and building materials used in the construction of sets that are used in the actual filming of a movie for sale, lease, or rental.[103] Prior to 2006, the sales tax on mill machinery was 1% of the sales price of the machinery, up to a maximum tax of $80 per article. Effective January 1, 2006, this reduced sales tax rate on mill machinery was repealed and replaced by a privilege tax having the same rate.[104] The General Assembly changed the taxation of mill machinery in response to the requirement of the Streamlined Sales Tax Agreement that states simplify their sales tax laws by having a uniform sales tax rate with no caps or thresholds.

North Carolina's refundable film credit is capped at $7.5 million. In order to obtain the credit, the taxpayer's qualifying expenses must exceed $250,000. The credit may be claimed for the taxable year in which the production activities are completed. The credit is computed based on all of the taxpayer's qualifying expenses incurred with respect to the production, not just the qualifying expenses incurred during the taxable year. If the credit exceeds the amount of tax imposed for the taxable year reduced by the sum of all credits allowable, the Secretary must refund the excess to the taxpayer. A pass-through entity is considered a taxpayer for purposes of claiming this credit; therefore, it does not distribute the credit among its owners.

The North Carolina Film Office commissioned two studies funded in partnership with EUE Screen Gems Studios, IATSE Local 491, Premiere Entertainment Services, Charlotte Regional Film Commission, Piedmont Triad Film Commission, Wilmington Regional Film Commission, Cinelease, and Illumination Dynamics:

- *"Economic and Fiscal Impacts of the North Carolina Film Credit Program",* June 2009, prepared by Ernest & Young. This study presents estimates of the economic and tax

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[102] The 1st edition of the bill, as passed by the Senate, increased the credit from 15% to 25% and became effective for taxable years beginning on or after January 1, 2009. The House Finance Committee changed the effective date to 2010 and limited the tax credit increase. The bill was rewritten to make the increased credit amount as an alternate credit because the limitation on the credit would have made the bill roll call in the Senate when it went back to the Senate for concurrence. Since the Senate received the bill from the House on August 8, 2009, the same day it adjourned, the bill could not have been enacted if it had been a roll call bill.

[103] North Carolina Department of Revenue Technical Bulletin, 20-4.

[104] The 2001 General Assembly enacted Article 5F of Chapter 105 of the General Statutes, the article that imposes a 1%, $80 privilege tax on certain machinery and equipment. The 2001 legislation became effective January 1, 2006.

impact of three components: film production activities; tourism related to NC films; and capital expenditures in NC film facilities.

- "*Economic Impact Study of the Production of a 'Mid-Major' Motion Picture on the Economy of Southeastern North Carolina*", Summer 2009, prepared by Dr. William Hall of the Cameron School of Business at the University of North Carolina at Wilmington. This study is a case study that identifies the spending impacts of a film on Brunswick, New Hanover, and Pender Counties.

Both studies recognize the number of jobs generated by film production in the State, the direct and indirect spending stimulus on the region's economy, the capital investments made by production companies, the resulting film generated tourism, and the contribution of these activities to the State and local government's tax collections.

The Ernest & Young study estimated the State's return on investment (ROI) from the refundable income tax credit. In forming the ROI estimate, the study analyzed the impact of the credit at the rate of 15% in 2007 and, using projections from the NC Film Office, estimated the impact of the credit at the rate of 25% for 2010 and 2011. The study found that film productions qualifying for the credit in 2007 accrued an estimated net present value of $22 million of refundable tax credit cost to the State and $29 million of State and local tax revenue. In considering State tax ROI, the study estimated the State's ROI was $0.98 for each dollar of tax credit expenditure. This estimate assumes that the film productions qualifying for the credit would not have been produced in the State in absence of the credit. The study estimated that the total State and local tax impacts from film productions, tourism, and capital expenditures related to film production would be $48 million in 2010 and $57 million in 2011 under a 25% tax credit. Under this scenario, the State tax ROI from each dollar of tax credit expenditure would be $0.69 in 2010 and $0.67 in 2011.

INCENTIVES FOR ENERGY CONSERVATION.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-548	**HB 512**	**Rep. Holliman, Harrison, Luebke**

AN ACT TO EXTEND THE CREDIT FOR INVESTING IN RENEWABLE ENERGY PROPERTY TO GEOTHERMAL HEAT PUMPS AND EQUIPMENT, TO ALLOW THE CREDIT TO BE TAKEN AGAINST THE GROSS PREMIUMS TAX, AND TO EXTEND THE SUNSET FOR THE CREDIT.

OVERVIEW: This act expands the renewable energy tax credit to geothermal heat pumps and equipment, allows the credit to be taken against the gross premiums tax, and extends the sunset of the credit.

FISCAL IMPACT: The act will reduce General Fund revenues by $0.4 million in fiscal years 2009-2010 and 2010-2011. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2009 Session. Available in the Legislative Library.)*

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

ANALYSIS: Under current law, the credit for investing in renewable energy property applies to any of the following machinery and equipment or real property:

- Biomass equipment that uses renewable biomass resources[105] for biofuel production of ethanol, methanol, and biodiesel; anaerobic biogas production of methane utilizing agricultural and animal waste or garbage; or commercial thermal or electrical generation from renewable energy crops or wood waste materials.
- Hydroelectric generators.
- Solar energy equipment.
- Wind equipment.

The act adds geothermal heat pumps and equipment to the definition of renewable energy property. Geothermal heat pumps use the ground or groundwater as a thermal energy source to heat a structure or as a thermal energy sink to cool a structure. Geothermal equipment uses the internal heat of the earth as a substitute for traditional energy for heating water or active space heating or cooling. The credit is capped at $8,400 per installation of a geothermal heat pump or geothermal equipment for residential property.

Under the current law, the amount of the credit for investing in renewable energy property is 35% of the cost of the property placed in service subject to a cap as set out in the table below. In the case of renewable energy property that services a single-family dwelling, the credit must be taken for the taxable year in which the property is placed in service. For all other renewable energy property, the credit must be taken in five equal installments, beginning with the taxable year in which the property is placed in service.

The credit may not exceed the following amounts:

TYPE OF PROPERTY	MAXIMUM CREDIT
Non-residential property.	The act increases the credit from $250,000 per installation to $2,500,000 per installation.
Residential property – Solar energy equipment for domestic water heating. The act clarifies that the credit also applies to solar energy equipment for pool heating.	$1,400 per dwelling unit.
Residential property – Solar energy equipment for active space heating, combined active space and domestic hot water systems, and passive space heating.	$3,500 per dwelling unit.
Residential property – Geothermal heat pumps and equipment.	$8,400 per installation.
Residential property – All other renewable energy property for residential purposes.	$10,500 per installation.

Under current law, the credit may be taken against the franchise tax or the income tax. The taxpayer must elect the tax against which the credit will be claimed when the credit is taken. The election is binding, and any carryforwards of the credit must be taken against the same

[105] Renewable biomass resources are organic matters produced by terrestrial and aquatic plants and animals, such as standing vegetation, forestry and agricultural residues, landfill wastes, animal wastes, and spent pulping liquor.

tax. This act allows a taxpayer to elect to take the credit against the gross premiums tax as well.

The renewable energy tax credit has the following limitations and conditions:

- The renewable energy tax credit may not exceed 50% of the tax against which it is claimed for the taxable year. Any unused portion of the credit may be carried forward for the succeeding five years.
- A taxpayer that claims any other credit allowed with respect to renewable energy property may not take the renewable energy tax credit with respect to the same property.
- A taxpayer may not take the renewable energy tax credit if the taxpayer leases the property from another person, unless the taxpayer obtains the lessor's written certification that the lessor will not claim a credit with respect to this property.
- The Department of Revenue must report each year on the number of taxpayers claiming the credits, the cost of the property for which the credits were claimed, and the total cost to the General Fund of the credits claimed.

The act also extends the sunset on the renewable energy tax credit from January 1, 2011 to January 1, 2016, and maintains the existing sunsets on the other credits in Article 3B (Business and Energy Tax Credits) of Chapter 105 of the General Statutes.

AFFILIATE LIABILITY FOR OTP EXCISE TAX.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-559	**SB 777**	**Senator Garrou**

AN ACT TO ALLOW AFFILIATES OF A TOBACCO PRODUCTS MANUFACTURER TO BE TREATED THE SAME AS THE MANUFACTURER FOR PURPOSES OF PAYMENT OF THE EXCISE TAX ON OTHER TOBACCO PRODUCTS, TO PROHIBIT INTEGRATED WHOLESALE DEALERS FROM SELLING, BORROWING, LOANING, OR EXCHANGING NON-TAX-PAID TOBACCO PRODUCTS OTHER THAN CIGARETTES TO, FROM, OR WITH OTHER INTEGRATED WHOLESALE DEALERS, AND TO REQUIRE PERSONS TRANSPORTING OTHER TOBACCO PRODUCTS TO FILE A SHIPPING REPORT WITH THE SECRETARY OF REVENUE.

OVERVIEW: This act amends the definition of an 'integrated wholesale dealer' for purposes of the excise tax on other tobacco products (OTP) so that an affiliate of a manufacturer of OTP may be treated the same as the manufacturer for purposes of allowing relief from paying the excise tax. The tax will be payable by the wholesale or retail dealer to whom the integrated wholesale dealer sold the product. The act also makes changes to better enable the Department of Revenue to track OTP sales, as requested by the Department.

FISCAL IMPACT: No impact. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2009 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The act became effective September 1, 2009.

Analysis: The excise tax rate on OTP is 10% of the cost price of the product. The tax is payable by the wholesale dealer or retail dealer who first acquires or otherwise handles OTP. By definition, all manufacturers are wholesale dealers. A manufacturer who is not a retail dealer

and who ships OTP to either a wholesale dealer or a retail dealer may apply to the Secretary of Revenue to be relieved of paying the tax.[106] Once granted permission, a manufacturer may choose not to pay the tax, which would result in the tax being paid by the wholesale or retail dealer to whom the manufacturer sells the product.

In 2007, the General Assembly provided that an integrated wholesale dealer may be treated like a manufacturer for purposes of allowing relief from paying the excise tax on OTP. The statute defines the term 'integrated wholesale dealer' as a wholesale dealer who is an affiliate of a manufacturer of other tobacco products and is the only person to whom the manufacturer sells its products.[107] This act eliminates the requirement in the definition of 'integrated wholesale dealer' that the manufacturer sells its entire product to its affiliate. This change allows an affiliate of a manufacturer of OTP to be treated the same as the manufacturer with respect to payment of the OTP excise tax, even if the manufacturer sells its products to someone other than the affiliate.[108]

The act also modifies the definition of manufacturer to include a contract manufacturer. Currently, contract manufacturers are not explicitly included in the OTP definition of 'manufacturer', but they are specifically included in the definition of a cigarette distributor.[109]

The act makes several changes at the request of the Department of Revenue to better enable the Department to track OTP purchases:

- It specifies that a contract manufacturer must be the exclusive purchaser of the products under the contract.
- It prohibits integrated wholesale dealers from selling, borrowing, loaning, or exchanging non-tax-paid OTP to, from, or with other integrated wholesale dealers.
- It requires a person who transports OTP upon the public highways, roads, or streets of this State to file a report, upon notice of the Secretary, in a form prescribed by and containing the information required by the Secretary. This requirement is similar to the one imposed under G.S. 105-113.18(3) for the transportation of cigarettes.

2008

DEFERRED PROPERTY TAX PROGRAMS CHANGES.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-35	**SB 1876**	**Senator Clodfelter**

[106] G.S. 105-113.35(d) establishes the procedure by which a manufacturer can be relieved of payment of the OTP excise tax.
[107] The change in 2007, for example, enabled Conwood Sales, an affiliate of Conwood Company, to be relieved of paying the tax on the OTP it received from Conwood Company since Conwood Company could be relieved of paying the tax.
[108] This change would allow Reynolds Tobacco, an affiliate of Conwood Company, to be relieved of paying the tax on the OTP it received from Conwood Company, even though Conwood sells part of its products to someone other than Reynolds Tobacco.
[109] G.S. 105-113.4(3).

AN ACT TO MODIFY THE CIRCUIT BREAKER TAX BENEFIT, TO STANDARDIZE ADMINISTRATION OF ALL DEFERRED PROPERTY TAX PROGRAMS, AND TO CORRECT THE EFFECTIVE DATE OF CHANGES TO THE HOMESTEAD EXCLUSION.

OVERVIEW: This act does the following:

- It modifies the property tax homestead circuit breaker program to ease the administration and implementation of the program.
- It consolidates the administrative provisions of North Carolina's property tax deferral programs into one statute.
- It simplifies the collection remedies for delinquent property taxes.
- It clarifies the property tax homestead income eligibility amount.

FISCAL IMPACT: No impact. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2008 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act is effective for taxes imposed for taxable years beginning on or after July 1, 2008.

ANALYSIS:

Part I: Circuit Breaker Modifications

In 2007, the General Assembly enacted a new property tax deferral program[110] for North Carolina residents who have owned and occupied property located in the State as a permanent residence for at least five years, who are either 65 years of age or older or totally and permanently disabled, and whose income for the preceding year does not exceed 150% of the income eligibility limit for the property tax homestead exclusion.[111] The homestead circuit breaker program becomes effective for taxes imposed for taxable years beginning on or after July 1, 2009. The amount of property tax an eligible owner may defer under the program varies depending upon the owner's income. An owner whose income is less than the income eligibility limit of the property tax homestead exclusion may defer the portion of taxes imposed on the permanent residence that exceeds four percent (4%) of the owner's income. An owner whose income is 100% to 150% of the income eligibility limit of the property tax homestead exclusion may defer the portion of taxes imposed on the permanent residence that exceeds five percent (5%) of the owner's income.

The Revenue Laws Study Committee reviewed the homestead circuit breaker program during the interim. It proposed several changes to the program it received from the Department of Revenue, the School of Government, and county tax assessors and collectors. The act does the following:

- It transfers the responsibility for notifying qualifying owners of the cumulative amount of deferred taxes, including interest, from the tax assessor to the tax collector. The tax collector has all the information needed to make this notification, even in counties where the towns located in it have a separate tax collector. Also, the tax collector is able to include this information on the property tax bills.

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[110] S.L. 2007-497.

[111] For taxable years beginning on or after July 1, 2008, the homestead exclusion income eligibility amount is $25,000. This amount is indexed annually. The amount for 2009 is $25,600.

- It eliminates the delay in using enforced collection remedies[112] for all disqualifying events other than the owner's death. Taxes deferred under the circuit breaker program become payable upon the occurrence of a disqualifying event: death of the owner, transfer of the residence by the owner, or cessation of use of the residence as a permanent residence by the owner other than a qualifying temporary absence.[113] Upon the occurrence of a disqualifying event, the amount of taxes for the year with no circuit breaker benefit plus those taxes deferred for the preceding three fiscal years, together with interest, become due. Under prior law, a tax collector could not enforce the collection of these taxes until nine months after the disqualifying event. This delay was unique among North Carolina's property tax deferral programs. The act eliminates the delay in using the enforced collection remedies for all disqualifying events other than the owner's death, where the nine-month delay remains.

- It converts the application process from a one-time application to an annual application. The application process for the property tax homestead circuit breaker was modeled after the homestead exclusion, which requires a single application. However, while eligibility for both programs is contingent on a taxpayer's income, the actual benefit received under the circuit breaker program is a function of different variables: the property value for the exclusion versus the taxpayer's income for the circuit breaker. Since the amount of the circuit breaker tax benefit is a function of the taxpayer's income, an annual reporting of income is necessary for the county to prepare the tax bill.

- It creates an exception to the tax secrecy provisions to allow agents of a county to disclose on a property tax receipt the amount of property taxes due and the amount of property taxes deferred under the homestead circuit breaker. Since the amount of taxes that can be deferred under the circuit breaker program is a function of income, and since counties make property tax records public, a person could use the amount of deferred taxes to calculate a qualifying owner's income. For this reason, the counties requested an exception to general rule that it cannot publish information about a taxpayer's income.

- It synchronizes the income eligibility limit for the 4% benefit under the homestead circuit breaker with the income eligibility limit for the homestead exclusion. Under prior law, there was a one-penny discrepancy between these income limits.

Part II: Deferral Program Modifications

North Carolina has six property tax deferral programs: (i) historic district property held as future site of historic structures[114] (ii) the circuit breaker tax deferral program[115] (iii) nonprofit property held as future site of low- or moderate-income housing[116] (iv) present-use value (PUV)

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[112] An enforced collection remedy is one or more of the collection remedies provided in G.S. 105-266 through 105-375 for delinquent property taxes. The remedies include attachment and garnishment and foreclosure.

[113] An exception to this rule exists, allowing deferral to continue if the residence is transferred to a spouse or qualifying co-owner and that individual qualifies for deferral and elects to continue deferral.

[114] G.S. 105-275(29a).

[115] G.S. 105-277.1B.

[116] G.S. 105-278.6(e).

property[117] (v) working waterfront property[118] and (vi) historic property.[119] The act creates a set of uniform provisions, applicable to all six programs. The provisions, several of which existed under prior law but were scattered among various statutes, are now collected in G.S. 105-277.1D and are as follows:

- Deferred taxes are due and payable on the day the property loses its eligibility for deferral as a result of a disqualifying event. This results in no change from prior law for any of the deferral programs.
- Interest accrues as of the date the taxes would have originally become due without the deferral program. This results in no change from prior law for any of the deferral programs.
- The tax for a year in which a disqualifying event occurs is computed without the benefit of the deferral program. This results in no change from prior law for any of the deferral programs.
- Liens resulting from deferred taxes are extinguished when the taxes are paid. This results in no change from prior law for any of the deferral programs.
- If part of a property on which taxes are deferred loses eligibility, the assessor determines the amount of deferred taxes that apply to that part and that amount is due and payable. Under prior law, the PUV, working waterfront property and historic property programs permitted partial loss of eligibility; the other programs[120] were an all-or-nothing system. The act permits partial loss of eligibility in all programs.
- All or part of taxes deferred may be paid at any time without affecting deferral eligibility, and partial payments are applied first to accrued interest, not the principal. The Department's construction of prior law was that a taxpayer could not make a partial payment of taxes deferred from previous years without withdrawing the property from the deferral program. This effectively forced a taxpayer to choose between paying down any accrued deferred taxes on eligible property and keeping the property in the deferral program. The act eliminates this disincentive and permits payment against accrued taxes and interest.

The act also consolidates the statutory provisions relevant to when and against whom a taxing unit may utilize enforced collection remedies. An enforced collection remedy is one or more of the collection remedies provided in G.S. 105-266 through 105-375 for delinquent property taxes. The remedies include attachment and garnishment and foreclosure. The act provides two sets of rules. The first set of rules provides that collection remedies may be enforced as of the date of delinquency. The date of delinquency is determined as follows:

- For normal taxes, the date of delinquency is the date the tax begins to accrue interest. Under G.S. 105-360, that date is January 6th.

[117] G.S. 105.277.4(c).
[118] G.S. 105-277.14.
[119] G.S. 105-278(b).
[120] Future historic site, future low- or moderate-income housing site, and the circuit breaker programs.

- For deferred taxes other than the circuit breaker where the disqualifying event is the death of the owner, the date of delinquency is the date a disqualifying event occurs.
- For deferred taxes under the circuit breaker where the disqualifying event is the death of the owner, the date of delinquency is the first day of the ninth month following the date of death.

The second set of rules provides against whom enforced collection remedies may be used:

- For delinquent taxes on real property, the taxing unit may proceed against the owner of record as of the date of delinquency and any subsequent owner.
- For delinquent taxes on personal property, the taxing unit may proceed against the owner of record as of January 1 of the calendar year in which the fiscal year of taxation begins.
- For delinquent taxes on registered motor vehicles, the taxing unit may proceed against the owner of record as of the date on which a new registration is applied for or on which the current vehicle registration is renewed.

Part III: Technical Change

Last year, the General Assembly enacted legislation increasing the income eligibility limit for the property tax homestead exclusion from $20,500 to $25,000.[121] The increase was supposed to take effect for taxable years beginning on July 1, 2008. A drafting error provided a different result. This act corrects the error to accomplish the intent of the original act.

MODIFY APPROPRIATIONS ACT OF 2007.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-107	**HB 2436**	**Rep. Michaux, Adams, Alexander, Crawford**

AN ACT TO MODIFY THE CURRENT OPERATIONS AND CAPITAL APPROPRIATIONS ACT OF 2007.

OVERVIEW, FISCAL IMPACT, AND EFFECTIVE DATES: *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2008 Session. Available in the Legislative Library.)*

Section	*Description & Effective Dates*	*Fiscal Impact*
Part I: Special Indebtedness		

[121] Prior to S.L. 2007-497, the income eligibility amount was statutorily set at $18,000. The statutory amount is indexed annually. In 2007, the indexed income eligibility amount was $20,500. S.L. 2007-497 changed the statutory amount from $18,000 to $25,000.

Section	Description & Effective Dates	Fiscal Impact
27.8	Special Indebtedness Projects – Authorizes the issuance of $709,034,944 of special indebtedness to finance various capital projects over the next four fiscal years. Of this amount, no more than $345,866,944 may be issued in fiscal year 2008-2009.	General fund debt service for this section and Section 27.9 is $17,500,000 for fiscal year 2008-2009.
27.9	Two-Thirds Bonds Act of 2008 – Authorizes the issuance of $107,000,000 of general obligation bonds for the Green Square Project.	General fund debt service for this section and Section 27.8 is $17,500,000 for fiscal year 2008-2009.
Part II: Individual & Corporate Income Tax Changes		
28.1	IRC Update – Updates the reference to the Internal Revenue Code to May 1, 2008, but decouples from the 50% bonus depreciation provision under the Economic Stimulus Act of 2008. This section is effective for taxable years beginning on or after January 1, 2008.	The impact on General Fund revenues is as follows: FY 2008-09: No impact FY 2009-10: Loss of $1.2 million FY 2010-11: Loss of $0.8 million FY 2011-12: Gain of $4.3 million FY 2012-13: Gain of $4.0 million
28.7	Close Franchise Tax Loopholes – Provides that limited liability companies that elect to be taxed as S corporations are subject to the franchise tax in the same manner as other S corporations and that captive REITS are subject to the franchise tax in the same manner as a corporation. This section of the act becomes effective for taxable years beginning on or after January 1, 2009.	Minimal impact.
28.8	Publicly Traded Partnerships – Requires a publicly traded partnership (PTP) that qualifies as a PTP under section 7704(c) of the Internal Revenue Code to file an informational return with the Secretary of Revenue that lists the partners who received more than $500 of income from the partnership during the taxable year. This section becomes effective for taxable years beginning on or after January 1, 2008.	Minimal impact.
28.9	Increase Earned Income Tax Credit to Five Percent – Increases the State's refundable earned income tax credit from 3.5% to 5%, effective for taxable years beginning on or after January 1, 2009.	Reduces General Fund revenues by $20.9 million beginning in fiscal year 2009-2010.

Section	Description & Effective Dates	Fiscal Impact
28.25	*Expand Renewable Energy Tax Credit – Allows an income tax credit for donating funds to a unit of State or local government for the purpose of enabling that unit to acquire renewable energy property. This section is effective for taxable years beginning on or after January 1, 2008.*	*Reduces General Fund revenues by $100,000 annually.*
28.27	*Tax Deduction for the Sale of a Manufactured Home Community to Manufactured Homeowners – Creates an income tax deduction equal to the taxable gain reported by a taxpayer from the qualified sale of a manufactured home community. This section is effective for taxable years beginning on or after January 1, 2008, and expires for taxable years beginning on or after January 1, 2015.*	*Reduces General Fund revenues by approximately $100,000 annually.*
Part III: Sales Tax Changes		
28.6	*Exempt Disaster Assistance Debit Sales – Exempts from sales tax tangible personal property purchased with a client assistance debit card issued for disaster assistance relief by a State agency or a federal agency or instrumentality. This section became effective August 1, 2008, and applies to purchases made on or after that date.*	*Reduces General Fund revenue by approximately $500,000 annually.*
28.12	*Sales Tax Holiday for Certain Energy Star Rated Appliances – Creates a sales tax holiday for energy efficient products for the first weekend of November. The holiday applies to the following Energy Star products: clothes washers, freezers and refrigerators, central air conditioners and room air conditioners, air-source heat pumps and geothermal heat pumps, ceiling fans, dehumidifiers, and programmable thermostats. This section became effective July 16, 2008.*	*Reduces General Fund revenue by $1.4 million annually.*
28.19	*State Sales Tax Exemption for Baked Goods Sold by Artisan Bakeries – Exempts bakery items sold by an artisan bakery from State sales tax, effective January 1, 2009.*	*Reduces General Fund revenues by $1.6 million for fiscal year 2008-2009 and by approximately $3.5 million for each year thereafter.*

Section	Description & Effective Dates	Fiscal Impact
28.20	Prohibit Tax on Interior Design Services – Exempts from sales tax interior design services provided in conjunction with the sale of tangible personal property. This section became effective August 1, 2008.	Reduces General Fund revenues by $100,000 annually.
28.21	1%, $80 Cap on Excise Tax on Machinery Refurbishers – Applies a 1% privilege tax, with an $80 cap, in lieu of sales tax on equipment purchased by an industrial machinery refurbishing company that is used in repairing or refurbishing tangible personal property. This section became effective July 1, 2008, and applies to purchases made on or after that date.	Reduces General Fund revenues by $300,000 for fiscal year 2008-2009 and by $500,000 annually each year thereafter.
28.22	Clarify 501(c)(3) Sales Tax Refund – Provides a definitive category of the type of nonprofit entity entitled to a semiannual sales and use tax refund. This section became effective July 1, 2008, and applies to purchases made on or after that date	Minimal fiscal impact.
Part IV: Economic Incentives		
28.2	Extend Credit for Research & Development – Extends from 2009 to 2014 the sunset on the income tax credit for qualified North Carolina research expenses or North Carolina University research expenses.	Reduces General Fund revenues as follows: FY 2008-09: $1.0 million FY 2009-10: $2.1 million FY 2010-11: $2.3 million FY 2011-12: $2.5 million FY 2012-13: $2.6 million
28.3	Extend Low-Income Housing Credit – Extends from 2010 to 2015 the sunset on the income tax credit that may be allocated to developers of low-income housing projects by the North Carolina Housing Finance Agency.	Reduces General Fund revenues as follows: FY 2008-09: -0- FY 2009-10: -0- FY 2010-11: -0- FY 2011-12: $22.1 million FY 2012-13: $45.2 million
28.4	Extend Mill Rehabilitation Credit – Extends the sunset for rehabilitation projects for which an application for an eligibility certification is submitted on or after January 1, 2011. Under prior law, the credit expired for qualified rehabilitation expenses occurring on or after that date.	Reduces General Fund revenues as follows: FY 2008-09: -0- FY 2009-10: -0- FY 2010-11: $1.5 million FY 2011-12: $3.4 million FY 2012-13: $4.2 million

Section	Description & Effective Dates	Fiscal Impact
28.5	Extend Sunset for State Ports Tax Credit – Extends from 2009 to 2014 the sunset on the income tax credit allowed to a taxpayer who loads or unloads cargo at either of the State-owned port terminals.	Reduces General Fund revenues as follows: FY 2008-09: $1.0 million FY 2009-10: $2.0 million FY 2010-11: $2.0 million FY 2011-12: $2.0 million
28.10	Extend Sunset for Small Business Employee Health Benefits – Extends from 2009 to 2010 the sunset on the tax credit available to small businesses that provide health benefits to all of their full-time employees.	Reduces General Fund revenues as follows: FY 2008-09: $8.5 million FY 2009-10: $17.7 million FY 2010-11: $10.1 million
28.23	Extend Aviation Fuel Refunds – Extends from January 1, 2009, to January 1, 2011, the sunset on the following two sales tax refund provisions: • Aviation fuel used by an interstate passenger air carrier. • Aviation fuel used by a motorsports racing team to travel to or from a motorsports.	Reduces General Fund revenues as follows: FY 2009-10: $1.6 million FY 2010-11: $3.2 million FY 2011-12: $1.6 million
28.24	Expand Film Industry Credit – Extends from 2009 to 2014 the sunset on the 15% tax credit available for productions over $250,000. The provision also expands the definition of qualifying expenses. This section is effective for taxable years beginning on or after January 1, 2008.	Reduces General Fund revenues as follows: FY 2008-09: $0.1 million FY 2009-10: $8.5 million FY 2010-11: $26.7 million FY 2011-12: $27.5 million FY 2012-13: $28.4 million
28.26	Increase Qualified Business Venture Tax Credit Cap – Increases from $7 to $7.5 million the total amount of all qualified business investments credits that may be taken each year. This section is effective for investments made on or after January 1, 2008.	Reduces General Fund revenues as follows: FY 2009-10: $0.5 million FY 2010-11: $0.5 million FY 2011-12: $0.5 million FY2012-13: $0.5 million
Part V: Estate & Gift Tax Changes		
28.17	Modify Estate Tax Law – Modifies the estate tax law to remove property from the estate tax base that the State cannot tax. This section became effective July 16, 2008, applies retroactively to the estates of decedents for which the statute of limitations for claiming a refund had not expired as of December 28, 2007.	Reduces General Fund revenues by $2 million in fiscal year 2008-2009; reduces revenues by approximately $500,000 annually thereafter.

Section	Description & Effective Dates	Fiscal Impact
28.18	***Repeal Gift Tax Law – Repeals the gift tax, effective January 1, 2009, and applicable to gifts made on or after that date.***	***Reduces General Fund revenues by $17.5 million for fiscal year 2009-2010.***
Part VI: Property Tax Changes		
28.9	***Provide a Property Tax Exclusion for Honorably Discharged Disabled Veterans and Their Surviving Spouses – Establishes a property tax homestead exemption for disabled veterans equal to the first $45,000 of the property's appraised value, effective for property tax years beginning on or after July 1, 2009.***	***No impact on State General Fund revenues. Reduces local government revenues by approximately $4.3 million.***
Part VII: Administrative Changes		
28.16	***Small Business Protection Act – Requires the Department to reduce an assessment for sales and use taxes imposed on a small retailer if certain circumstances exist and to document advice given to taxpayers in certain situations. The majority of this section became effective when the Governor signed the act into law on July 16, 2008. The requirement that the Department document advice given to taxpayers related to sales tax application becomes effective January 1, 2009. The requirement that the Department document advice related to whether a taxpayer must register as a retailer or wholesale merchant under Article 5 of Chapter 105 becomes effective July 1, 2009.***	***Reduces General Fund revenues by $2.2 million for fiscal year 2009-2010 and by $500,000 annually thereafter.***
28.28	***Procedure for Tax Class Actions – Establishes a procedure for initiating or joining a tax class action in which a taxpayer is seeking the refund of a tax paid under an alleged unconstitutional statute. This section is effective October 1, 2008, and applies to actions filed on or after that date.***	***Indeterminable.***

ANALYSIS:

Part I: State Indebtedness

Special Indebtedness. – Section 27.8 authorizes the issuance of $709,034,944 of special indebtedness to finance a variety of State capital projects over the next four fiscal years. Of this amount, only $345,866,944 may be issued or incurred during fiscal year 2008-2009. This amount of indebtedness is within the recommended guidelines of the NC Debt Affordability

Advisory Committee.[122] The NC Debt Affordability General Fund Model Guidelines recommends that General Fund debt service should be targeted at no more than 4% of General Fund revenues and should not exceed 4.75% of General Fund revenues. Based on projected General Fund revenues, the model calculates that the State could annually authorize $479,700,000 of new tax-supported debt over the next five years and remain within its targeted ratio. This section became effective when the Governor signed the act into law on July 16, 2008.

Special indebtedness[123] is non-voted debt that is typically secured only by an interest in the State property being acquired or improved. The term 'special indebtedness' covers both financing contract indebtedness and limited obligation bond indebtedness. Financing contract indebtedness may take the form of a lease purchase, an installment purchase, or a certificate of participation.[124] The form of debt anticipated for these issuances is limited obligation bonds. Since 2000, the State has relied exclusively on the authorization of special indebtedness to finance capital projects.

The capital projects financed in this section through special indebtedness include the following:

- Facilities for the University of North Carolina.
- Additions to several correctional institutions.
- The purchase of State judicial facilities located at 901 Corporate Drive in Raleigh.
- The acquisition of State park lands and conservation areas for the Land for Tomorrow initiative.
- Various other State capital projects, such as the completion of an oyster hatchery, improvements at the State ports in Morehead City and Wilmington, expansion and renovation to the polar bear exhibit at the N.C. Zoo, and construction of a Southeastern North Carolina Agriculture Center Pavilion.

Two-Thirds Bonds Act of 2008. – Section 27.9 authorizes the issuance of $107,000,000 of non-voted general obligation bond indebtedness to finance the Green Square Project. This section became effective when the Governor signed the act into law on July 16, 2008.
General obligation bond indebtedness is secured by the faith and credit and taxing power of the State. As a general rule, general obligation bond indebtedness must be approved by the voters. However, under Article V, Sec. 3(a)(f) of the North Carolina Constitution, the State may

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[122] The 2008 Debt Affordability Study may be accessed at www.nctreasurer.com.

[123] Before any type of special indebtedness may be issued or incurred, the State Treasurer must certify that debt financing may be desirable for a specific project presented to it by the Department of Administration. Next, the Council of State must give preliminary approval. If preliminary approval is obtained, the Council of State must give final approval, setting out details such as the maximum amount to be financed, the maximum maturity, and the maximum interest rates. The maximum maturity may not exceed 40 years. The State Treasurer must approve the details of the financing, finding that the amount to be borrowed is adequate and not excessive and will not require an excessive increase in any State revenues to provide for repayment, and that the special indebtedness can be incurred or issued on terms favorable to the State. Finally, the State Treasurer must report to the Joint Legislative Commission on Governmental Operations at least five days before any special indebtedness is issued or incurred.

[124] Certificate of participation indebtedness involves a plan of finance in which a special corporation obtains funds to pay the cost of a capital facility to be financed through the delivery by the special corporation of certificates of participation. Limited obligation bond indebtedness does not require the presence of a special corporation.

issue non-voted general obligation bonds in an amount not to exceed 2/3 of the amount by which it reduced its outstanding general obligation debt in the preceding biennium. Based upon this formula, the State could have issued up to $125,000,000 of non-voted general obligation bonds for fiscal year 2008-2009.

The Green Square Project consists of an office building for the Department of Environment and Natural Resources, the construction of a Nature Research Center for the NC Museum of Natural Science, and an underground parking deck with 426 spaces. The project also consists of another parking deck, authorized in S.L. 2006-231, which will house up to 900 spaces. The total cost of the project, excluding the parking deck authorized in 2006, is $150,000,000. The General Assembly appropriated $25,000,000 for the project last year. Parking receipts will service the debt for parking construction and the Friends of the Museum of Natural Science have committed $27,500,000 towards the cost of the Nature Research Center and $15,500,000 towards the cost of the exhibits.

Part II: Individual and Corporate Income Tax Changes

IRC Update. – Section 28.1 updates from January 1, 2007, to May 1, 2008, the reference to the Internal Revenue Code used in defining and determining certain State tax provisions. However, this section also requires an 85% addback of the bonus depreciation allowed under the Economic Stimulus Act of 2008 in order to achieve revenue neutrality for fiscal year 2008-2009. The Revenue Laws Study Committee recommended this provision, and the Governor included it in his revenue recommendations. This section is effective for taxable years beginning on or after January 1, 2008.

North Carolina's tax law tracks many provisions of the federal Internal Revenue Code by reference to the Code.[125] The General Assembly determines each year whether to update this reference.[126] Updating the 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. Changing the reference date to May 1, 2008, incorporates, with the one major exception mentioned above, the changes made by the following acts: the Economic Stimulus Act of 2008, the Mortgage Forgiveness Debt Relief Act of 2007, and the Small Business and Work Opportunity Tax Act of 2007.[127]

Enacted on February 13, 2008, the Economic Stimulus Act of 2008[128] (ESA) was a $152 billion package designed to stimulate the economy through rebates for individual taxpayers and

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[125] 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.

[126] 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."

[127] A more detailed summary of recent amendments to the Code is available upon request.

[128] P.L. 110-185.

incentives for businesses.[129] Those incentives are the 50% bonus depreciation provision for qualifying property placed in service in 2008, the increased limits for section 179 expensing of qualified property in 2008, and increased depreciation limits for 'luxury' autos predominantly used for business. North Carolina is not conforming to the bonus depreciation provision but does conform to the other business incentives.

- **50% Bonus Depreciation Provision.**[130] Under this section, North Carolina decouples from the federal accelerated depreciation schedule allowed under the ESA. Over the life of an asset placed in service during 2008, taxpayers will be able to deduct the same amount of the asset's basis under both federal and State law; it is just that the timing of the deduction will differ. To accomplish this decoupling, the section does two things:
    - It requires a taxpayer to add back to federal taxable income 85% of the accelerated depreciation amount[131] in the year the accelerated depreciation is claimed for federal purposes.[132]
    - In tax years beginning on or after January 1, 2009, it allows a taxpayer to deduct from federal taxable income the total amount of the add-back required for either the 2007 or 2008 tax year, divided into five equal installments.

  This means that for State tax purposes, a taxpayer may deduct a greater depreciation amount in the outlying tax years, which will be the normal depreciation amount plus 20% of the accelerated depreciation amount the taxpayer had to add back. The purpose of this recovery provision is to enable the taxpayer to have the same basis in assets for federal and State purposes. Without this deduction provision, a taxpayer would have a different basis in the depreciable asset for State and federal purposes and would have to keep separate books and records for State and federal purposes until the disposal of the asset. In effect, the add-back and subsequent deduction will affect the timing of the impact of bonus depreciation on the State but it will not increase or decrease the total amount of revenue the State receives over the affected years.

  Under the ESA, a taxpayer is entitled to depreciate in the first year 50% of the adjusted basis of certain qualified property placed in service during the 2008 calendar year.[133] To claim bonus depreciation, the property must be one of the following types:
    - Eligible for the modified accelerated cost recovery system (MACRS) with a depreciation of 20 years or less.

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[129] The rebates, which are technically "advance credit payments," do not impact State revenues and are not discussed in this analysis.

[130] Bonus depreciation allows a business to claim more of a deduction up front and spread the remainder out over the normal depreciation schedule. However, over the life of the asset the taxpayer still receives the same benefit. Congress has authorized bonus depreciation several times to encourage business investment, specifically after September 11, 2001. The Jobs Creation and Worker Assistance Act of 2002 provided a 30% bonus depreciation allowance. The Jobs and Growth Tax Relief Reconciliation Act of 2003 extended the sunset and increased the amount to 50%.

[131] The accelerated depreciation amount for property placed in service in 2008 is 50%.

[132] The add-back means that for State tax purposes, a taxpayer deducts less in that tax year than the taxpayer would have deducted if the State conformed to the accelerated depreciation provision.

[133] The placed-in-service date is extended one year, through December 31, 2009, for property with a recovery period of 10 years or longer, for transportation property, and for certain aircraft.

- Water utility property
- Off-the-shelf computer software
- Qualified leasehold property.

Generally speaking, bonus depreciation is available for every item of tangible personal property, except inventory, property used outside the U.S., and property depreciated under the alternative depreciation system. Other than computer software, it is not available for intangibles. Bonus depreciation is not allowed if property is sold in the same year that it is placed in service.

- **Increased Section 179 Expensing Limits. –** This section conforms to the increased expensing limits authorized under the ESA. In general, a qualifying taxpayer may elect to treat the cost of certain property as an expense and deduct it in the year the property is placed in service instead of depreciating it over several years. This property is frequently referred to as section 179 property, after the relevant section in the Code. To be eligible, the property must be tangible personal property that is actively used in the taxpayer's business for which a depreciation deduction would be allowed. The property must be used more than 50% for business and must be newly purchased property. Generally, taxpayers take the expensing deduction first and claim section 168(k) depreciation on any remaining basis.

  Prior to the ESA, the deduction was limited to $128,000 of the cost of the property with a phase-out at $510,000 for 2008. The new law temporarily doubles the limitation to $250,000.[134] The threshold for reducing the deduction is also increased to $800,000 with a complete phase-out once qualifying purchases exceed $1.05 million. These limitations apply only to property purchased and placed in service in tax years beginning in 2008. The limitations will return to the lower levels for tax years beginning in 2009.

- **Increased Depreciation Limits for 'Luxury' Autos.** – This section conforms to the increased the depreciation limits on luxury vehicles under the ESA.[135] A luxury vehicle is one that costs more than the 'luxury auto price floor', which is adjusted annually for inflation along with the depreciation limits. The first-year limit on depreciation for passenger vehicles placed in service in 2008 is projected to be $2,960 for automobiles and $3,160 for vans and trucks. The new law raises the cap by $8,000 for a maximum first-year depreciation of $10,960 for autos and $11,160 for vans and trucks.

Close Franchise Tax Loopholes. – Section 28.7 changes the franchise tax laws as follows to conform with changes the General Assembly made in 2006 and 2007 to the corporate income tax laws:

- It provides that limited liability companies (LLCs) that elect to be taxed as S corporations for income tax purposes are subject to the franchise tax in the same manner as other S corporations
- It provides that captive real estate investment trusts (REITs) are subject to the franchise tax since they are treated as corporations for income tax purposes.

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[134] The new law does not alter the section 179 limitation imposed on sport utility vehicles, which have an expense limit of $25,000.

[135] These limits were increased when bonus depreciation was previously available.

The Revenue Laws Study Committee recommended these changes, upon the suggestion of the Department of Revenue.[136] This section is effective for taxable years beginning on or after January 1, 2009.

Prior to 2006, a LLC did not pay franchise tax. In 2006, the General Assembly amended the definition of 'corporation', as it applies to the franchise tax statutes, to include a LLC that elects to be taxed as a C corporation for federal income tax purposes.[137] The Department of Revenue began to receive questions from S corporations as to whether they could convert to a LLC and elect to be treated as an S corporation for income tax purposes, thereby becoming exempt from franchise tax.[138] To curb this potential franchise tax loophole, this section makes a similar change to the one enacted in 2006; it provides that a LLC that elects to be treated as a corporation for income tax purposes, either a C corporation or a S corporation, is also considered a corporation for franchise tax purposes.

In 2007, the General Assembly limited a corporation's ability to use captive REITs to avoid State taxes by disallowing the dividend paid deduction when a REIT is a captive REIT.[139] The effect of this change is that a captive REIT is treated as a regular corporation for income tax purposes. This section provides that a captive REIT will also be treated as a regular corporation for franchise tax purposes. Under the current franchise tax law, a REIT may, in determining its value for franchise tax purposes, deduct the aggregate market value of its investments in the stocks, bonds, debentures, or other securities or evidences of debt of other corporations, partnerships, individuals, municipalities, governmental agencies or governments. This section changes the statute to provide that this deduction may only be used by a REIT that is not a captive REIT. A REIT is an organization that uses the pooled capital of many investors to purchase and manage real estate. A captive REIT is one that is owned or controlled by a single entity.

Publicly Traded Partnerships. – A partnership doing business in this State must file an information return with the Department of Revenue that gives the name and address of each person who would be entitled to share in the partnership's net income, if distributable, and the amount each person's distributive share would be. A partnership that files a report must also furnish to each partner the information needed by that partner to file a North Carolina income tax return. For nonresident members of a partnership, the partnership must pay income tax for that partner based on the partner's distributive share.

Section 28.8 changes the reporting and payment requirements that apply to a publicly traded partnership (PTP) that is described in section 7704(c) of the Internal Revenue Code. It requires a qualifying PTP to report annually to the Department the partners in the PTP who received more than $500 of income rather than report the income received by every partner. It also exempts qualifying PTPs from the requirement to pay tax on the partnership income received by a nonresident. The Revenue Laws Study Committee recommended this tax law change.[140] In making this recommendation, the Committee sought to strike a balance between the costs and burden of compliance with the reporting requirements for both the PTPs and the Department and the benefits gained by compliance. This section is effective for taxable years beginning on or after January 1, 2008.

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[136] HB 2508 and SB 1755.
[137] S.L. 2006-66, Section 24A.2.
[138] In 2005, S corporations paid more than $50 million in franchise tax.
[139] S.L. 2007-323, Section 31.18.
[140] HB 2508 and SB 1755.

A PTP is a limited partnership the interests in which are traded on stock exchanges such as the New York, American, and NASDAQ exchanges. Unlike a traditional partnership, a PTP has tens of thousands, and sometimes hundreds of thousands, of unitholders. A PTP's unitholders can change daily in trades on public exchanges. A PTP determines who its unitholders are once a year so the PTP can send K-1s to the unitholders.

PTPs initially came into existence during the 1980s as a means for companies to raise large amounts of capital needed to build or buy capital-intensive assets, like pipelines. When initially created, PTPs were taxed as partnerships. Congress began reviewing the PTP structure and its use in 1986. Congress determined that the structure was needed for certain types of entities in energy related businesses and it enacted legislation allowing PTPs described in section 7704(c) of the Code to continue to be treated like a partnership for income tax purposes. All other types of PTPs are taxed as a corporation. A PTP described in section 7704(c) of the Code is one that generates 90% of its income from qualified sources. Qualified sources include real estate activities, mineral or natural resources activities like exploration, production, mining, refining, marketing, and transportation of oil, gas, minerals, geothermal energy, and timber. There are approximately 90 PTPs in the country that meet the description in section 7704(c) of the Code, and 10 of these PTPS are located in North Carolina.

The Multi-State Tax Commission (MTC) adopted a model statute in December 2003 that exempts PTPs described in section 7704(c) of the Code from paying tax on partnership income received by a nonresident member so long as the PTP agrees to file an annual information return reporting the name, address, and taxpayer identification number of each unitholder with an income in the state in excess of $500. This section adopts the substance of the MTC model statute. Twenty-six states have excluded PTPs from tax payment requirements for nonresident partners through either specific legislation or administrative action. Eight states exempt PTPs from reporting distributions to its partners except for distributions of income that exceed $1,000 during the taxable year.

Increase Earned Income Tax Credit to Five Percent. – Section 28.9 increases the amount of the State's refundable earned income tax credit from 3.5% of an individual's federal earned income tax credit amount to 5%, effective for taxable years beginning on or after January 1, 2009.[141] The General Assembly enacted a refundable State earned income tax credit in 2007, effective for taxable years beginning on or after January 1, 2008.

The Internal Revenue Code provides an earned income tax credit for individuals who work and whose adjusted gross income does not exceed a specified amount. The credit is intended to offset some of the increases in living expenses and social security taxes and provide an incentive for low-income families to work instead of collect welfare. The amount of the credit may exceed the amount of tax owed by the taxpayer. If the credit allowed exceeds the amount of tax imposed, the excess is refundable to the taxpayer.

The amount of the federal credit varies depending upon whether the taxpayer has children and the amount of earned income the taxpayer has. The credit is phased out as the taxpayer's earned income rises. The earned income amounts and the credit amounts are indexed annually to inflation.

Tax Deduction for the Sale of a Manufactured Home Community to Manufactured Homeowners.[142] – Section 28.27 allows a taxpayer to deduct from federal taxable income the taxable gain

[141] HB 2642.

[142] The House Finance Committee originally considered the tax deduction in House Bill 1700.

from a qualified sale of a manufactured home community. A 'qualified sale' is a sale of land comprising a manufactured home community that is transferred in a single purchase to a group composed of a majority of the manufactured home community leaseholders, or to a nonprofit organization representing such a group. To qualify for this deduction, the taxpayer must give notice of the sale to the North Carolina Housing Finance Agency.[143] The deduction becomes effective for taxable years beginning on or after January 1, 2008, and expires for taxable years beginning on or after January 1, 2015.

Part III: Sales Tax Changes

Exempt Disaster Assistance Debit Sales. – Section 28.6 exempts from sales tax tangible personal property purchased with a client assistance debit card issued for disaster assistance relief by a State agency or a federal agency or instrumentality. The American Red Cross (ARC) is an instrumentality of a federal agency. Another example of a federal agency or instrumentality that may utilize this exemption would be the Federal Emergency Management Agency (FEMA). This section became effective August 1, 2008, and applies to purchases made on or after that date.

A state may not impose its sales tax on purchases made by the federal government or an instrumentality of the federal government. G.S. 105-164.13(17) specifically exempts from North Carolina sales tax 'sales which a state would be without power to tax under the limitations of the Constitution or laws of the United States or under the Constitution of this State.' Sales made pursuant to a disbursing order issued by a federal governmental agency or instrumentality is considered a sale to the government that is exempt from taxation. However, for purposes of the sales tax exemption, there is a significant difference between a debit card and a disbursing order: the purchaser, for purposes of the sales tax exemption, is the disaster victim when a debit card is used and it is the disbursing entity when the disbursing order is used. This section extends the same sales tax treatment that exists for purchases made through a disbursing order issued by a federal agency or instrumentality to purchases made with a client assistance debit card issued by it. This section became effective August 1, 2008, and applies to purchases made on or after that date.

The Revenue Laws Study Committee recommended this tax law change after representatives of the ARC brought the issue to the Committee's attention.[144] Over the last few years, the ARC has begun giving disaster victims debit cards to purchase tangible personal property. The ARC began using debit cards because it believes they are more efficient, effective, and less bureaucratic for the victim and less administrative effort and expense for the organization. The ARC client assistance card clearly identifies itself as one issued by the ARC. The ARC has the ability to see from its reports of the card's use the amount purchased and the store from which the goods were purchased. Unlike the old disbursing order system, the ARC does not have a cash register receipt describing the specific items purchased. The client assistance card authorization form is a contract between the ARC and the disaster victim. The contract stipulates the types of items the card may be used to purchase. In the event of inappropriate purchases, the card can be suspended.

Sales Tax Holiday for Certain Energy Star-Rated Appliances. – Section 28.12 creates a State and local sales and use tax exemption, applicable during the first weekend in November,[145]

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[143] G.S. 42-14.3 requires an owner of a manufactured home community to notify the owners of the homes in the community of intent to convert the property to another use.

[144] SB 1703 and HB 2336.

[145] The holiday period begins 12:01 AM on the first Friday of November and ends 11:59 PM on the following Sunday.

for the following Energy Star-rated products: clothes washers, freezers and refrigerators, central air conditioners and room air conditioners, air-source heat pumps and geothermal heat pumps, ceiling fans, dehumidifiers, and programmable thermostats.[146] An Energy Star-rated product is one that meets the energy efficient guidelines set by the United States Environmental Protection Agency (EPA) and the United States Department of Energy and is authorized to carry the Energy Star label. The exemption does not apply to the sale of a product for use in a trade or business or to the rental of a product. This section became effective when the Governor signed the act into law on July 16, 2008.

The EPA introduced Energy Star in 1992 as a voluntary labeling program designed to identify and promote energy-efficient products to reduce greenhouse gas emissions. Energy Star-labeled products deliver the same or better performance as comparable models while using less energy and saving money. The program delivers the technical information and tools that aid in choosing energy-efficient solutions and best management practices. In 1996, EPA began including major appliances, office equipment, lighting, home electronics, and more in its Energy Star program. In 2007, Energy Star products delivered energy and cost savings of about $16 billion, and, over the past decade, the program has encouraged such technological innovations as efficient fluorescent lighting, power management systems for office equipment, and low standby energy use.

North Carolina participates in the Streamlined Sales and Use Tax Agreement. Under that Agreement, a state may not have a sales tax holiday unless the items to be exempted during the holiday are specifically defined in the Agreement's provisions concerning sales tax holidays. Until recently, the Agreement did not have a definition in its provisions governing sales tax holidays for energy efficient products; therefore, North Carolina could not institute a sales tax holiday for these products and remain compliant with the Agreement. As of April 2, 2008, the necessary definitions have been added to the Agreement, thus permitting the establishment of a sales tax holiday for energy efficient products. North Carolina has had a sales tax holiday during the first weekend in August for certain qualifying school supplies and articles of clothing since 2001.[147]

State Sales Tax Exemption for Baked Goods Sold by Artisan Bakeries. – Section 28.19 reduces the sales tax applicable to bakery items sold by artisan bakeries by exempting them from the general State sales tax rate. Effective January 1, 2009, bakery items sold by an artisan bakery will be taxed at the applicable local sales tax rate, as opposed to the combined general rate applicable to prepared foods. An artisan bakery is one that meets both of the following requirements:

- It derives over 80% of its gross receipts from bakery items.
- Its annual gross receipts, combined with the gross receipts of all related persons, do not exceed $1,800,000.

For several years, North Carolina has grappled with the issue of the taxation of bakery items. The term 'bakery item' is a subset of the defined term 'prepared food'. North Carolina imposes a higher sales tax rate on prepared food than food.[148] The distinction between food and

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[146] The House first considered the sales tax holiday for energy star products in HB 2605. The Governor included a similar provision in his budget recommendation to the 2008 General Assembly.
[147] G.S. 105-164.13C.
[148] There is a local sales tax of 2% on food while prepared food is subject to the general State sales tax rate of 4.25% and applicable local rates, which range from 2.5% to 2.75%. Several cities and counties impose a prepared food tax, in addition to the State and local sales tax.

prepared food often becomes complex.[149] The Senate Finance Committee heard testimony from many small bakeries across the State that they received conflicting information about the applicable tax rate they should impose on their bakery items. The conflicting information resulted in many bakeries being assessed additional tax, along with interest and penalties, because they taxed their bakery items at the incorrect, lower rate. The bakeries also argued that the differential tax rates imposed an unfair economic burden on their goods.

North Carolina is one of the 17 member states that have modified their sales and use tax laws to comply with the uniform provisions of the Streamlined Sales and Use Tax Agreement (Agreement). The Agreement is a multistate agreement that seeks to simplify and modernize sales and use tax administration in the member states. The Agreement does not influence whether a state imposes sales and use tax on an item or exempts it from tax. However, if a member state chooses to tax an item or exempt an item, it must adhere to the provisions concerning the definition of an item as defined in the Agreement.

The Agreement, as it existed when North Carolina adopted the uniform definitions for food and prepared food in 2001, did not include a distinction among the types of prepared food. Therefore, the choice before the General Assembly was to either tax all prepared food or exempt all prepared food. The State chose to tax all prepared food.

Later versions of the Agreement included a carve-out for bakery items from the defined term 'prepared food' to address problems some states began encountering in this area. The carve-out provides that bakery items may be taxed differently than other types of prepared food if they are sold without eating utensils provided by the seller. The Agreement defines 'bakery items' as bread, rolls, buns, biscuits, bagels, croissants, pastries, donuts, Danish, cakes, tortes, pies, tarts, muffins, bars, cookies, and tortillas.

This section provides that bakery items, as that term is defined in the Agreement, are taxed as food if the item is sold by an artisan bakery. [150] The section does not lower the tax rate on all bakery items.[151] It also does not change the application of the local meals taxes because the act does not change the definition of prepared food. Therefore, in the applicable jurisdictions, the meals tax will continue to apply to all bakery items, regardless of who sells them.

Prohibit Tax on Interior Design Services. – Section 28.20 eliminates the sales and use tax on interior design services provided in conjunction with the sale of tangible personal property. This section became effective August 1, 2008. Charges for interior design or consulting services by an interior designer or decorator are not subject to sales or use tax. However, charges for services made in conjunction with the sale of tangible personal property are subject to sales or use tax because they are considered part of the sales price of the property. The definition of 'sales price' is the total amount or consideration for which tangible personal property is sold,

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[149] Any food item prepared by a retailer and sold by the retailer to a consumer is a prepared food and is subject to the State and local sales tax rates. A similar product produced by someone else, but sold by the same retailer, is food and is exempt from State sales tax. For example, slaw prepared by Harris Teeter and sold in its deli section is prepared food. Slaw produced by someone else and sold at Harris Teeter is food. Likewise, the same product may be taxed differently depending upon where it is purchased. For example, a donut purchased at the place where it is made is prepared food. The same donut purchased at a grocery store is food.

[150] Under the Agreement, a state may enact an entity-based exemption for a product defined in the Agreement so long as the state defines the product consistent with its definition in the Agreement.

[151] SB 1630 would have reduced the sales tax rate applicable to all bakery items, regardless of who sold them.

leased, or rented. The consideration may be in the form of cash, credit, property, or services necessary to complete the sale.[152]

Discerning when services constitute part of the sales price of a product is often difficult with respect to transactions in which the product transferred is largely the result of personal services. At the two extremes, there is no great difficulty. When an attorney draws a will, there is no difficulty in concluding that services have been rendered, even though the document the client receives embodying the services constitutes tangible personal property. At the other extreme, when an artist renders a painting, the sale of the painting is a sale of tangible personal property, even though the value of the painting is attributable to the talent of the artist and not the cost of the canvas and paint. The great difficulty lies with transactions in the middle. Determining the proper treatment of services rendered in connection with the sale of a product is among the most frequently litigated issues in the area of sales tax.

The rule a number of states use to help resolve the difficulty of determining when services rendered should constitute part of the sales price of a product is whether the 'true object' of the buyer was to acquire the finished product or the service rendered. If the true object sought by the buyer is to obtain the property produced by the service, then the services are necessary to complete the sale and should be included in the computation of the sales price of the product.

Over the past several months, the Department of Revenue audited some interior designers and decorators and assessed sales tax on services they found necessary to complete the sale of the tangible personal property sold by the designer or decorator. Many of the interior designers and decorators appealed the assessment of the tax and brought the issue to the attention of legislators.[153] This section does not affect the assessments imposed under the prior law.

This section also does not address other transactions in which the tangible personal property transferred is largely the result of personal services. The Department issued a technical bulletin on May 1, 2008, that provides guidance as to when services and sales are subject to sales or use tax. The bulletin provides the following guidelines:

- Charges for services rendered before the sale of tangible personal property are not subject to sales or use tax. A taxpayer's records must clearly establish that an agreement to sell tangible personal property was made after the completion of interior design services.
- Charges for services unrelated to the sale of tangible personal property are not subject to sales or use tax.
- Charges for services with incidental sales of property are not subject to sales or use tax. An incidental sale is defined as a sale where the charges for the tangible personal property equal 20% or less of the total combined charges for the tangible personal property.

1%, $80 Cap on Excise Tax on Machinery Refurbishers. – Section 28.21 expands Article 5F of Chapter 105 of the General Statutes to provide that the 1% privilege tax, with a cap of $80, applies to an industrial machinery refurbishing company that purchases equipment or an attachment or repair part for equipment used by the company in repairing or refurbishing tangible personal property owned by a third party. Property subject to the excise tax under Article 5F is exempt from sales and use tax. The change from a sales tax to a privilege tax not

[152] G.S. 105-164.3(37).

[153] SB 1657 passed the Senate Finance Committee and became the basis for this section in the budget.

only means a lower tax rate for the property purchased but also means that retailers are not responsible for collecting and remitting the tax. The change became effective July 1, 2008, and applies to purchases made on or after that date.[154]

The 2001 General Assembly enacted Article 5F in response to the requirement of the Streamlined Sales and Use Tax Agreement that states must simplify their sales tax rates. The 2001 legislation, which became effective January 1, 2006, repealed the 1% sales tax rate, with an $80 cap, imposed on mill machinery purchased by a manufacturing industry or plant and replaced it with a privilege tax having the same rate. The Article has been expanded since its enactment to apply to purchases of fuel and equipment and machinery by a number of different industries, including:

- Fuel, other than electricity or piped natural gas, purchased by a manufacturing industry or plant to operate the industry or plant.
- Certain personal property purchased by a major recycling facility.
- Equipment purchased by a research and development company in the physical, engineering, and life sciences and used by that company in the research and development of tangible personal property.
- Equipment purchased by a software publishing company that is used in the research and development of tangible personal property.
- Equipment purchased by an eligible datacenter.

The Senate Finance Committee originally considered the issue of whether purchases of machinery and equipment by a machine refurbisher should be treated similarly to mill machinery purchased by a manufacturing industry in Senate Bill 1745.[155] For purposes of the mill machinery provision in Article 5F, a "manufacturing industry or plant" is an entity which manufactures articles for sale or some equivalent commercial purpose. The Department of Revenue held in both private letter rulings and at least two final decisions that a business that refurbishes or refinishes items of tangible personal property owned by a third party performs a service and is not engaged in manufacturing. Consequently, the machinery and equipment used in the refurbishing process was not eligible for the 1% privilege tax rate prior to the passage of this legislation. Instead, the purchases were subject to the combined general rate of sales and use tax.

Clarify 501(c)(3) Sales Tax Refund.[156] – Section 28.22 provides objective criteria to determine whether an organization is a nonprofit charitable institution eligible to receive a semiannual refund of sales and use taxes paid by it on direct purchases of tangible personal property and services used to carry on the work of the nonprofit entity. This section became effective July 1, 2008.

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[154] SB 1745, as passed by the Senate, would have made this provision effective July 1, 2006, and applicable to purchases made on or after that date and to assessments made on or after that date for prior purchases. This bill became the basis for this provision. However, the retroactive effective date was not retained.

[155] Under SB 1743, the change in the law would have become effective July 1, 2006, and applied to purchases made on or after that date and to assessments made on or after that date for prior purchases. The provision enacted in this act did not retain the retroactive effective date.

[156] The Senate Finance Committee originally considered this issue in Senate Bill 2106.

Prior to this change, the Department of Revenue had to determine whether a nonprofit entity requesting a sales and use tax refund qualified as a 'charitable institution'.[157] To make its determination, the Department relied on past determinations and court decisions. Under *Southmister, Inc. v. Justice*, the court defined a charitable organization as one "engaged in the relief or aid to a certain class of persons, a corporate body established for public use, or a private institution created and maintained for the purposes of dispensing some public good or benevolence to those who require it." In May of 2008, the North Carolina Court of Appeals appeared to expand the definition of charitable organization in *The Lynnwood Foundation v. N.C. Department of Revenue* when it affirmed a trial court's ruling that the Department erred in denying a sales and use tax refund to The Lynnwood Foundation. In 2004, the Department determined that the Lynnwood Foundation[158] no longer qualified[159] as a charitable organization for purposes of the sales and use tax refund for the following reasons: it did not engage in relief or aid to a charitable class; it operated for profit; and it did not use the taxed property for a charitable purpose. The Lynnwood Foundation appealed the decision and the trial court granted summary judgment in the Lynnwood Foundation's favor. The trial court found that the preservation of historic sites was a charitable purpose; that the Lynnwood Foundation's overall expenses exceeded its overall income; and that the Lynnwood Foundation only sought a refund for the sales and use taxes it paid on items that it used in carrying out its charitable work.[160]

This section seeks to clarify the prior law, not to expand it. It provides a bright line test for determining whether a nonprofit entity is a charitable one by relying upon section 501(c)(3) of the Internal Revenue Code (Code) and the National Taxonomy of Exempt Entities (NTEE). The NTEE is a classification system categorizing charitable organizations with 501(c)(3) status by organizational mission into 26 subgroups based on Internal Revenue Service (IRS) activity codes. The activity codes provide detail on the operational activities of an organization that has been granted 501(c)(3) status. The IRS assigns an activity code to a charitable organization based on information provided by the organization at the time of application for 501(c)(3) status.

Effective July 1, 2008, a nonprofit entity may receive a sales tax refund if it is exempt from income tax under section 501(c)(3) of the Code but not designated as one of the following organizations under the NTEE:

- Community improvement, capacity building organization.
- Public, society benefit, multipurpose organization.
- Mutual/membership benefits organization.
- Organization whose mission or purpose is unknown.

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[157] Under prior law, the refund applied to educational institutions, churches, orphanages, and *other charitable or religious institutions* not operated for profit. It continues to apply to nonprofit hospitals and qualified retirement facilities.

[158] The Lynnwood Foundation was incorporated in 1996 as a charitable organization to preserve and restore the Duke Mansion. In 1997 the Department determined that the Lynnwood Foundation was entitled to a refund of a portion of sales and use tax paid.

[159] The Lynnwood Foundation began operating the Duke Mansion as a conference and lodging facility in 1998. The Department reexamined the Lynnwood Foundation's status as a charitable organization within the meaning of the sales and use tax refund statute in 2002.

[160] The Foundation paid more than $239,000 in sales and use taxes from July 2004 through December 2005. It sought to recover $14,700. During the same period, the Foundation expended over $2 million towards preserving the property.

According to the National Center for Charitable Statistics, as of November 2006 there were 11,901 active North Carolina based organizations with IRS 501(c)(3) status.[161] Of these 11,901 active organizations, 599 are classified within one of the four NTEE classifications excluded from receiving a sales tax refund. It is not known how many of these organizations received a sales tax refund under the prior law. Likewise, an organization that may have been determined by the Department to be ineligible for a sales tax refund in the past may be eligible under the new law. The Fiscal Research Division expects that the number of organizations and quantity of refunds affected by the change will be minimal.

Expand Renewable Energy Tax Credit. – Section 28.25 expands the income tax credit available to a taxpayer who donates funds to a tax-exempt nonprofit organization for the purpose of providing fund for the organization to invest in renewable energy property[162] to include similar donations made to a unit of State or local government. A taxpayer who claims this credit may not also claim the donation as a charitable contribution. This section became effective for taxable years beginning on or after January 1, 2008.

The amount of the credit is equal to the taxpayer's share of the credit the governmental entity could claim under G.S. 105-129.16A[163] if it was subject to tax. The credit under G.S. 105-129.16A is equal to 35% of the cost of the property placed in service. The taxpayer's share of the credit is equal to the following calculation: (taxpayer's donation / cost of the renewable energy property of governmental entity placed in service that year as a result of the donation) X (the amount of the credit the governmental entity could claim if it were subject to tax). The credit must be taken in the year in which the property is placed in service.[164] The credit may be taken against either the income tax or the franchise tax and it may not exceed 50% of the taxpayer's of the tax against which it is claimed.

A governmental entity must keep a record of all donations it receives for renewable energy property and the amount of the donations used for this purpose. If the entity places renewable energy property in service, it must give each taxpayer who made a donation a statement setting out the amount of the credit the taxpayer qualifies for, a description of the renewable energy property placed in service, the cost of the property, the amount of the credit the entity could claim under G.S. 105-129.16A if it were subject to tax, and the taxpayer's share of the credit allowed. If the donations made for the renewable energy property exceed the cost of the property, the entity must prorate each taxpayer's share of the credit.

Part IV: Economic Incentives

This act extends the sunsets on and, in some instances, expands the scope of several tax credits. Tax credits are one of many economic incentives offered by the State designed to attract and maintain businesses in North Carolina. In 1998, the Revenue Laws Study Committee

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[161] An active organization is one that filed a federal 990 Form with the IRS between November 2004 and November 2006.

[162] Renewable energy property includes biomass equipment that uses renewable biomass resources for biofuel production of ethanol, methanol, and biodiesel; anaerobic biogas production of methane utilizing agricultural and animal waste or garbage; commercial thermal or electrical generation from renewable energy crops or wood waste materials; hydroelectric generators; solar energy equipment; and wind equipment. Renewable biomass resources are organic matters produced by terrestrial and aquatic plants and animals.

[163] G.S. 105-129.16A is repealed effective for renewable energy property placed into service on or after January 1, 2011.

[164] The installment requirements in G.S. 105-129.16A for nonresidential property do not apply to this credit.

recommended that sunsets be placed on virtually all of the tax credits as a means to review and reevaluate those credits to determine whether they are accomplishing their intended goal. The Committee engaged in this review process during the 2007 interim and recommended extensions for the following three credits: the credit for research and development, the credit for the State Ports Authority, and the credit for small business employee health benefits. During the 2008 Session, the General Assembly extended or modified the sunset on three additional credits: the credit for low-income housing, the credit for mill rehabilitation, and the film industry credit. In addition to the extension of these credits, the General Assembly expanded the scope of the film industry and renewable energy tax credit and increased the cap on the qualified business venture tax credit.

These economic incentives are described more fully as follows and appear in the order in which they appear in the budget.

Extend Credit for Research & Development. – Section 28.2 extends for five years, until the year 2014, the sunset on this tax credit. Prior to the enactment of this section, the credit was scheduled to expire for taxable years beginning on or after January 1, 2009. This section became effective when the Governor signed the act into law on July 16, 2008.

In 2004, the General Assembly enacted this credit as an alternative to the Bill Lee research and development credit, which was set to expire along with the entire Bill Lee Act on January 1, 2006. A taxpayer that has qualified North Carolina research expenses or North Carolina university research expenses is allowed a credit. The taxpayer must satisfy Bill Lee Act requirements related to employee wages, the provision of health insurance, the taxpayer's Occupational Safety and Health Act record, and the taxpayer's environmental record. A taxpayer with overdue tax debts is not prohibited from taking this credit.

The credit amount varies. For North Carolina university research expenses, the credit amount is equal to 20% of the amount the taxpayer paid to the university for the research and development. For all other qualified research expenses, the credit is equal to a percentage of the expenses. Specifically, the rate is 3.25% for small businesses[165] and for research and development conducted in a development tier one area. For other research and development expenditures, the rate ranges from 1.25% to 3.25% as the amount of those expenditures increases.

Extend Low-Income Housing Credit. – Section 28.3 extends the sunset on the low-income housing tax credit from January 1, 2010, until January 1, 2015. Although the sunset was not scheduled to expire for two more years, developers of low-income housing begin their work months in advance and need to know what financing will be available as they secure options on sites. This section became effective when the Governor signed the act into law on July 16, 2008.

Congress enacted the federal Low Income Housing Tax Credit in 1986 to fund housing for low- and moderate-income households. Each state receives a limited amount of credit each year. The Internal Revenue Service (IRS) allocates the per capita low-income housing tax credit to state housing agencies such as the North Carolina Housing Finance Agency (HFA), which in turn allocate the credit to project developers who agree to lower project rents for low-income tenants.

[165] A small business is a business whose annual receipts, combined with the annual receipts of all related persons, does not exceed $1,000,000.

In 1999, North Carolina authorized a State income tax credit modeled after the federal housing credit.[166] Under current law, a taxpayer may elect to receive the credit in the form of either a credit against tax liability or a loan generated by transferring the credit to the HFA in return for a 0% interest 30-year balloon loan equal to the credit amount. Historically, project developers have almost always elected the loan option. Neither a tax refund generated by the credit, nor a loan received as a result of the transfer of the credit is considered taxable income by the State. Although a State tax refund is considered taxable income by the IRS if the taxpayer itemizes deductions, a private letter ruling from the IRS provides that the loan proceeds are not.

Extend Mill Rehabilitation Tax Credit. – Section 28.4 extends the sunset for rehabilitation projects for which an application for an eligibility certification is submitted on or after January 1, 2011. Under prior law, the credit expired for qualified rehabilitation expenses occurring on or after that date. This section also makes clarifying and stylistic changes. This section is effective for taxable years beginning on or after January 1, 2008.

North Carolina allows a tax credit for rehabilitating vacant historic manufacturing sites if the taxpayer spends at least $3 million to rehabilitate the site. To qualify for the credit, the site must satisfy all of the following conditions:

- The site was used as a manufacturing facility or for purposes ancillary to manufacturing, as a warehouse for selling agricultural products, or as a public or private utility.
- The site is a certified historic structure or a State-certified historic structure.
- The site has been at least 80% vacant for a period of at least two years immediately preceding the date the eligibility certification is made.

The amount of the credit is a percentage of the qualified rehabilitation expenditures, and the percentage varies depending on the enterprise tier location of the site and the eligibility for the federal credit as follows:

- Development tier one or two area – 40% of qualified rehabilitation expenditures or rehabilitation expenses, regardless of whether the taxpayer is allowed a federal credit.
- Development tier three area – 30% of qualified rehabilitation expenditures and the taxpayer is allowed a federal credit. No credit is allowed if the site is located in a development tier three and the taxpayer is not allowed a federal credit.

The credit may be claimed against the franchise tax, the income tax, or the gross premiums tax. If the credit is taken for income-producing property, it may be taken in the year the property is placed in service. If the credit is taken for non-income-producing property, the credit must be taken in five equal installments beginning with the taxable year in which the property is placed in service. The credit may not exceed the amount of the tax against which the credit is claimed for the taxable year reduced by the sum of all credits allowed, except payment of tax made by the taxpayer. Any unused portion of the credit may be carried forward for the succeeding

[166] Under the original version of the State credit, a project developer had to sell the tax credits to receive funds to finance the project. Developers indicated that the process of selling the credits was complex and that they sold for no more than 45 cents on the dollar. In 2002, the General Assembly modified the way in which developers benefited from the credit to promote efficiency and cost savings while providing the same level of incentives.

nine years. This credit may be taken in place of the credit for historic rehabilitation, not in addition to it.

A pass-through entity may allocate the credit among any of its owners without limitation as long as the owner's adjusted basis in the pass-through entity is at least 40% of the amount of credit allocated to the owner.[167] An owner of a pass–through entity that qualifies for the credit will forfeit a portion of any credit the owner has received if both of the following conditions are met:

- The owner disposed of the interest within five years from the date the eligible site is placed into service.
- The owner's interest in the pass-through entity is reduced to less than two-thirds of the owner's interest in the pass-through entity at the time the eligible site was placed into service.

The forfeiture of an owner's interest is not required if the change in ownership is the result of the owner's death or the merger, consolidation, or similar transaction requiring approval by the shareholders, partners, or members of the entity, to the extent the entity does not receive cash or tangible property in the transaction. A taxpayer or owner of a pass-through entity that forfeits a credit is liable for all past taxes avoided as a result of the credit plus interest computed from the date the taxes would have been due if the credit had not been allowed.

Extend Sunset for State Ports Tax Credit. – Section 28.5 of the act extends for five years, until the year 2014, the sunset on this tax credit. Prior to the enactment of this section, the credit was scheduled to expire for taxable years beginning on or after January 1, 2009. This section became effective when the Governor signed the act into law on July 16, 2008.

In 1992, the General Assembly enacted the State Ports tax credit to encourage exporters to use the two State-owned port terminals in Wilmington and Morehead City. At that time, the credit applied to amounts paid by a taxpayer on any cargo exported at either port. Over the years, the credit has been expanded and the sunset has been extended four times.

Currently, the State Ports tax credit is allowed to a taxpayer who loads or unloads waterborne cargo from an ocean carrier at the State-owned port terminal at Wilmington or Morehead City. The credit is allowed against the taxpayer's income tax. The taxpayer may be either an individual or a corporation. The amount of the tax credit is equal to the amount of wharfage, handling, and throughput charges paid to the North Carolina State Ports Authority in the taxable year that exceeds the average amount of charges paid to the Authority for the current tax year and the two previous tax years. The credit is limited to 50% of the tax imposed on the taxpayer for the taxable year. Any excess credit may be carried forward and applied to the taxpayer's income tax liability for the next five years. The maximum cumulative credit that one taxpayer may claim is $2 million.

Extend Sunset for Small Business Employee Health Benefits. – Section 28.10 extends from January 1, 2009, to January 1, 2010, the sunset on this tax credit. This section became effective when the Governor signed the act into law on July 16, 2008.

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[167] A pass-through entity may also allocate the credit for rehabilitating an historic structure among its owners in the same manner as provided in this provision.

Effective for taxable years beginning on or after January 1, 2007, a small business[168] that provides health benefits to all of its full-time employees[169] is eligible for a tax credit. 'Providing health benefits' means one or more of the following:

- The taxpayer pays at least 50% of the premiums for health insurance coverage that equals or exceeds the minimum provisions of the basic health care plan of coverage recommended by the Small Employer Carrier Committee.
- The employee has existing coverage under one or more of the following: Medicare; Medicaid; a government funded program; a health insurance or benefit arrangement that provides benefits similar to or in excess of benefits provided under the basic health care plan.

The credit amount is equal to $250 per employee for whom the taxpayer pays the health insurance premium, not to exceed the taxpayer's cost of providing the health insurance benefit. The taxpayer may use the credit against either its income tax or its franchise tax liability. The credit may not exceed 50% of the taxpayer's tax liability. Any unused portions of the credit may be carried forward for five years.

Under the Internal Revenue Code, an employer may deduct premiums paid for health insurance cost of its employees as a business expense. The credit is in addition to any expense deduction the taxpayer claimed on its income tax return for the health insurance costs.

Extend Aviation Fuel Refunds.[170] – Section 28.23 extends the sunset for refunds of the State sales and use tax paid on fuel used by interstate passenger air carriers and on aviation fuel used by a professional motorsports racing team or a motorsports sanctioning body from January 1, 2009, to January 1, 2011.[171] To receive a refund, a taxpayer must submit a refund request in writing and include any information and documentation required by the Secretary of Revenue. The request is due within six months after the end of the calendar year for which the refund is claimed.

In 2005, the General Assembly allowed a sales and use tax refund to an interstate passenger air carrier for the net amount of sales and use tax paid by it on fuel during a calendar year in excess of $2,500,000.[172] The 'net amount of sales and use taxes paid' is the amount of sales tax paid by the interstate passenger air carrier less the refund of that tax allowed to all interstate carriers under subsection (a) of G.S. 105-164.14.[173] The refund for which the sunset provision is being extended is in addition to the refund allowed under G.S. 105-164.14(a).

In that same year, the General Assembly enacted a refund of sales and use taxes paid on aviation fuel by a motorsports racing team or motorsports sanctioning body. In order to qualify for the refund, the fuel must have been used to travel to or from a motorsports event in this

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[168] A 'small business' is a taxpayer that employs no more than 25 full-time employees.
[169] An 'eligible employee' is one that works a normal workweek of 30 or more hours and whose total wages or salary received from the business does not exceed $40,000 on annual basis.
[170] The Senate Finance Committee originally considered the sunset extension in Senate Bill 2113.
[171] S.L. 2006-66 extended the sunset on these two sales tax refund provisions from January 1, 2007, to January 1, 2009.
[172] S.L. 2005-435.
[173] Under subsection (a), an interstate carrier is allowed a refund of a portion of the sales and use taxes paid by the carrier on fuel, lubricants, repair parts, and accessories purchased in this State. The refund is equal to a proportion of the sales and use taxes paid by the carrier in this State. The proportion is equal to the proportion of the miles traveled by the carrier in this State to the total miles traveled by the carrier.

State, from this State to a motorsports event in another State, or to this State from a motorsports event in another State. For the purposes of the refund, a 'motorsports event' includes a motorsports race, a motorsports sponsor event, and motorsports testing.

Expand Film Industry Credit and Extend Sunset. – Section 28.24 extends for four years, until January 1, 2014, the sunset on this tax credit and makes several other changes to the credit. This section became effective for taxable years beginning on or after January 1, 2008.

This credit is a refundable income tax credit equal to 15% of the qualifying expenses spent by a production company in connection with a production. However, the amount of the credit with respect to a feature film production is capped at $7.5 million. In order to obtain the credit, the taxpayer must have qualifying expenses in excess of $250,000. Qualifying expenses are the total amount spent in North Carolina for the following:

- Goods and services purchased by a production company in connection with a production.
- Compensation and wages paid by a production company on which it remitted withholding payments to the Department of Revenue. Under prior law, any amount paid to an individual who receives in excess of $1 million with respect to a single production may not be included in a qualifying expense. The section modifies this limitation by allowing a production company to include in its qualifying expenses up to $1 million in compensation paid to a highly compensated individual.[174] Any amount paid in excess of $1 million continues to be disallowed.

This section makes three additional changes to the credit. First, it allows a production company to include in its qualifying expenses the cost of insurance coverage for production-related insurance that is obtained on the production. The expenses do not qualify if the insurance coverage is purchased from a related member, which is defined in the current law. Second, it requires a taxpayer who claims the credit to file an intent-to-film notice with the North Carolina Film Office. The notice must include the name of the production, the name of the production company, the name of a financial contact for the production company, the proposed dates on which the production company plans to begin filing the production, and any other information required by the NC Film Office. This provision codifies current administrative practice.[175] Finally, it requires a taxpayer to acknowledge in the production credits both the North Carolina Film Office and the regional film office responsible for the geographic area in which the filming of the production occurred.

Increase Qualified Business Venture Tax Credit Cap. – Section 28.26 increases from $7 to $7.5 million the total amount of all qualified business investment credits that may be taken each year.[176] Demand for the credit exceeded $7 million in 2006 and totaled more than $6.5 million in 2007. This section is effective for investments made on or after January 1, 2008.

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[174] 'Highly compensated individual' is defined as 'An individual who directly or indirectly receives compensation in excess of one million dollars ($1,000,000) for personal services with respect to a single production. An individual receives compensation indirectly when a production company pays a personal service company or an employee leasing company that pays the individual.'

[175] A production may not claim the credit until the production is complete. As written, the notification and acknowledgement requirements are conditions to receiving the credit. It would be possible for a company that has begun production to be denied a credit because it failed to meet these requirements, even though the requirements did not exist at the time the company began, or possibly completed, its production.

[176] The Senate considered this issue in Senate Bill 1628.

The qualified business investment tax credit is allowed for an individual taxpayer who purchases the equity securities or subordinated debt of a qualified business venture, a qualified grantee business, or a qualified licensee business directly from that business. The credit is equal to 25% of the amount invested and may not exceed $50,000 per individual in a single taxable year. An individual investor may also claim the allocable share of credits obtained by pass-through entities of which the investor is an owner. Pass-through entities include limited partnerships, general partnerships, S corporations, and limited liability companies. The credit may not be taken in the year the investment is made. Instead, the credit is taken in the year following the calendar year in which the investment was made, but only if the taxpayer files an application with the Secretary of Revenue. Any unused credit may be carried forward for the next five years. The Secretary of Revenue calculates the total amount of tax credits claimed from applications filed. If the amount exceeds the cap, then the Secretary allows a portion of the tax credits claimed by allocating the total amount of credits allowed in proportion to the size of the credit claimed by each taxpayer. In general, a taxpayer forfeits the credit if the taxpayer transfers the securities within one year or the qualified business redeems the securities purchased by the taxpayer within five years after the investment was made. This credit is currently set to expire for investments made on or after January 1, 2011.

Part V: Estate & Gift Tax Changes

Modify Estate Tax Law. – Section 28.17 modifies the formula for calculating North Carolina estate tax on estates that include property located in another state by excluding the value of that property from the estate tax payable to North Carolina, as recommended by the Revenue Laws Study Committee.[177] The section became effective July 16, 2008, and applies retroactively to the estates of decedents for which the statute of limitations for claiming a refund had not expired on December 27, 2007. [178] A personal representative of an estate for which the statute of limitations had not expired may file a claim for refund under G.S. 105-241.6. The statute provides that the general statute of limitations for obtaining a refund of an overpayment of tax is the later of the following:

- Three years after the due date of the return. – A North Carolina estate tax return is due on the date a federal estate tax return is due. A federal estate tax return is due nine months from the date of death. An extension of time to file a federal estate tax return is an automatic extension of the time to file a State tax return.
- Two years after payment of the tax.

For estates with property only in North Carolina, the North Carolina estate tax equals the amount of the credit allowed on the federal estate tax return for state estate tax paid, as the federal law provided in 2001. If an estate has property in more than one state, the federal credit amount must be prorated between North Carolina and the other states in which the estate

[177] SB 1756.

[178] A case has been filed in Mecklenburg County, *Stowe v. Department of Revenue*, to recover North Carolina estate taxes imposed on property located in South Carolina. The plaintiffs argue in their complaint that the formula for calculating North Carolina estate tax due when property is located in more than one state is unconstitutional because it provides less than a full reduction of the tax attributable to the out of state property when the other state does not impose an estate tax, or imposes an estate tax less than the prorated federal credit amount. The plaintiffs filed the complaint on December 27, 2007.

has property. In 2002, the Estate Tax Section of the North Carolina Bar Association recommended a change in the calculation formula from a net value ratio to a gross value ratio. The recommended change also provided that when the estate of a North Carolina decedent included out-of-state property, the North Carolina estate tax would be calculated as the amount of the 2001 tax credit reduced by the lesser of the amount of estate tax paid to the other state or the amount of the 2001 tax credit times the value of the out-of-state property divided by the value of the gross estate.

In calculating the estate tax payable in North Carolina for an estate that includes property located in a state that does not impose an estate tax, the formula, prior to its modification by this section, provided that the North Carolina estate tax would be reduced by zero, because that is the lesser of the amount paid to the state that does not impose an estate tax. This calculation resulted in North Carolina's estate tax being imposed on property that is not located within its taxing jurisdiction. The application of the formula was especially problematic for North Carolina because the states surrounding North Carolina do not have an estate tax. Virginia repealed its estate tax, effective July 1, 2007. Georgia, South Carolina, and Tennessee have not had an estate tax since January 1, 2005, because their estate tax equals the amount of the state estate tax credit allowed on the federal estate tax return. In 2001, Congress phased out the state estate tax credit over four years by reducing it 25% in 2002, 50% in 2003, 75% in 2004, and by repealing it entirely in 2005.[179]

This section modifies the formula for calculating North Carolina estate tax on estates that include property located in another state by prorating the federal credit amount between North Carolina and the other states in which the estate has property. It does so by eliminating the 'lesser of" language that sometimes results in North Carolina's estate tax being imposed on property located in another state.

Repeal Gift Tax Law. – Section 28.18 repeals North Carolina's gift tax law, effective January 1, 2009. The nuances of North Carolina's gift tax laws make the transfer of property through gifts difficult and complicate estate planning. The North Carolina Association of CPAs and the Estate and Gift Tax Section of the North Carolina Bar Association have consistently recommended that North Carolina eliminate or simplify its gift tax law. The Revenue Laws Study Committee recommended legislation to the 2007 General Assembly to reform the State's gift tax to more closely conform to the federal tax, but the General Assembly did not enact the bill. Although the Committee did not recommend legislation on this issue this session, it recognized the need to simplify the State's gift tax laws.

With the repeal of the gift tax in North Carolina, Connecticut and Tennessee remain the only two states in the nation to impose a tax on gifts. Some of the reasons for repealing North Carolina's gift tax law included:

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[179] The federal estate tax changes were part of the Economic Growth and Tax Relief Reconciliation Act of 2001. Under the provisions of that Act, the state estate tax credit phased-out, the federal estate tax exclusion amounts increased gradually, and the top rates decreased gradually until 2010 when the tax is repealed. However, the provisions are currently set to expire for estates of decedents dying after December 31, 2010. Effective January 1, 2011, the federal estate tax law will return to the provisions that existed in the year 2000 unless Congress enacts new legislation. Therefore, effective 2011, the state estate tax credit will exist again and the applicable exclusion amounts and tax rates will return to the amounts that existed in 2000.

- North Carolina taxes gifts at varying graduated rates based on the relationship between the donor and the donee.[180] It favors transfers between spouses by exempting those transfers from tax. It favors transfers to children and parents by giving those transfers the lowest rates as well as a cumulative exemption amount of $100,000. Transfers to other close family members are taxed at higher rates and do not enjoy the benefit of an exemption. Transfers to more distant relatives or to persons who are not related are taxed at the highest rate.
- North Carolina's gift tax structure does not conform well to the federal gift tax structure.[181] 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. One result of this difference is that some transfers made while the donor is alive are taxable in North Carolina, although the same transfer made by a decedent would not be taxable.[182]
- There are sometimes differences in the valuation of a gift for State and federal tax purposes. This discrepancy 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.
- A donee assumes the donor's basis when property is transferred by gift. A donee assumes a stepped-up basis when the property is transferred through an estate.

Part VI: Property Tax Exclusion for Honorably Discharged Disabled Veterans and their Surviving Spouses.

Section 28.11 repeals the property tax exclusion for the first $38,000 in assessed value of housing for disabled veterans receiving benefits under 38 U.S.C. § 2101 and, in its place, creates a property tax homestead exclusion equal to the first $45,000 in assessed value of a permanent residence owned by an honorably discharged veteran or the unmarried surviving spouse of an honorably discharged veteran. This exclusion does not have an age requirement or an income requirement. The exclusion becomes effective for taxes imposed for taxable years beginning on or after July 1, 2009.

To receive the exclusion, a property owner must file an application[183] with the county tax assessor. To qualify for the exclusion, the property owner must meet one of the following requirements, or be the unmarried surviving spouse of a person who met one of these requirements:

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[180] North Carolina is the only state whose gift tax rate structure differs depending on the relationship between the donor and the donee.

[181] Connecticut's gift tax structure conforms to the federal gift tax system. North Carolina and Tennessee's does not.

[182] Accountants and estate planning attorneys found that the consequences of the gift tax affects the estate planning of middle-income citizens in that it discourages them from transferring a farm or small business to their natural heirs during their lifetime because they cannot afford to pay the applicable State gift tax.

[183] The application need be filed only once.

- A disabled veteran who receives benefits under 38 U.S.C. § 2101.
- A disabled veteran certified by the U.S. Government or the U.S. Department of Veterans Affairs as a person with a permanent total disability that is service-connected.

A taxpayer who receives the disabled veteran property tax exclusion may not benefit from any other homestead property tax exclusion. However, if the permanent residence is owned by more than one person who is not the taxpayer's spouse, and a co-owner qualifies for a property tax relief program, then the co-owner may receive the benefits of that program.[184] The exclusion allowed to either co-owner may not exceed the co-owner's proportionate share of the valuation of the property and the amount of the exclusion allowed to all co-owners may not exceed the greater of two applicable exclusion amounts.

North Carolina also provides the following property tax exclusions for disabled veterans:

- A property tax exclusion for a motor vehicle given by the U.S. Government to veterans on account of disabilities they suffered in WWII, the Korean, Conflict, or the Vietnam War.
- A property tax exclusion for a motor vehicle owned by a disabled veteran if the vehicle has been altered with special equipment to accommodate a service-connected disability. A service-connected disability is an injury incurred or disease contracted in or aggravated by active service. The disability must be loss of one or both hands or feet, permanent loss of use of one or both hands or feet, or permanent impairment of vision of both eyes.

Part VII: Administrative Changes

Small Business Protection Act. – Section 28.16 provides small businesses with certain protections related to their sales and use tax obligations, it requires the Department of Revenue to establish and implement procedures for improving customer service and quality control measures with regard to advice given to taxpayers in certain areas of the tax law, and it directs the Revenue Laws Study Committee to study issues related to the interpretation and application of certain areas of the sales and use tax law.

Under this section, the Secretary is required to reduce an assessment for sales and use taxes made against a small business as the result of an audit and waive any associated penalties if all of the following conditions are met:

- The annual gross receipts of the business and all related persons for the calendar year preceding the year in which the audit period begins do not exceed $1.8 million dollars.
- The business remitted all the sales and use taxes it collected during the audit period.
- The business had not been told by the Department in a prior audit to collect sales and use taxes in the circumstance that is the basis of the assessment.
- The business made a good faith effort to comply with the sales and use tax laws and the assessment is based on the incorrect application of one of the following complex areas of these laws:
    - The rate of tax that applies to prepared food.

[184] G.S. 105-277.1 provides a property tax exclusion for elderly or disabled taxpayers who meet an income eligibility limit.

- The distinction between a retailer and a performance contractor.
- The distinction between a service that is necessary to complete the sale of tangible personal property, which is taxable, and a service that is incidental to the sale of tangible personal property, which is not taxable.
- The determination of whether a person is a manufacturer.

The amount of the reduction is a percentage of the assessment and varies depending on the average monthly gross receipts of the business:

Avg. Monthly Gross Receipts	Reduction of Assessment
$ 0- 50,000	98%
$ 50,001-100,000	95%
$ 100,001-150,000	90%

In addition to applying prospectively to future assessments and claims for the refund of an assessment, this section also has limited retroactive application. Specifically, it applies to assessments that are pending as of July 15, 2008, to assessments that have been identified in a notice of final assessment under former G.S. 105-241.1 prior to July 15, 2008, or to assessments that became collectible but have not been paid as of July 15, 2008. If, however, an assessment was paid within six months after it became collectible, then the taxpayer may also be eligible for a reduction if a timely claim for refund could be filed.

During the 2008 Session, the Senate and House Finance Committees heard from a number of small business owners who expressed concern and confusion regarding the application to their particular businesses of certain sales and use tax provisions and, in some instances, verbal information provided by the Department of Revenue that they believed to be erroneous or unclear. This section attempts to address either the actual or perceived issues of quality control within the Department with respect to verbal advice given to taxpayers. Specifically, this section requires the Department to document certain conversations with taxpayers, regardless of whether the conversation is conducted by phone or in person. Effective January 1, 2009, the Department must document advice given to a taxpayer when the taxpayer provides identifying information, asks about the application of a tax to the taxpayer in specific circumstances, and requests that the Secretary document the advice in the taxpayer's records. The documentation must set out the date of the conversation, the question asked, and the advice given. This requirement does not apply in a conference or presentation-type setting. Effective July 1, 2009, the Department must document in a similar manner a conversation with a taxpayer who is not registered as a retailer or a wholesale merchant under Article 5 of Chapter 105 of the General Statutes when the taxpayer identifies himself, describes the business in which he is engaged, and asks if he is required to be registered under Article 5.

Under current law, a taxpayer may request in writing specific advice from the Department. If the Department furnishes erroneous written advice in response, and the taxpayer reasonably relies on that advice, the taxpayer is not liable for any penalty or additional assessment attributable to the erroneous advice. However, the same protection does not apply with regard to verbal advice. Effective July 16, 2008, when the act became law, this same protection is extended to taxpayers with regard to erroneous verbal advice provided that Departmental records establish that the erroneous advice was given.

This section rewrites the offer and compromise statute so that it more accurately reflects current practice, is adjusted for inflation, and eliminates the requirement that the Department obtain approval from the Attorney General unless the matter is in litigation. It also adds a new condition

under which the Department may settle a tax liability for less than that asserted to be due; that is, when the collection of an amount greater than the amount offered would produce an unjust result under the circumstances. The rewrite of this statute is intended, in part, to provide the Department with additional flexibility with regard to offers and compromise.

This section requires the Department to do two things. First, the Department must establish and implement by July 1, 2010, a plan to record telephone calls received at the Taxpayer Assistance Center for training, customer service, and quality control purposes. Second, the Department must report to the Revenue Laws Study Committee, prior to the convening of the 2009 General Assembly, on customer service improvement initiatives.

Finally, it directs the Revenue Laws Study Committee to study the following issues related to the interpretation and application of certain areas of the sales and use tax law that frequently cause confusion among taxpayers and often result in inadvertent noncompliance:

- The taxation of services necessary to complete the sale of tangible personal property and standards for distinguishing between a service that is taxable as one that is necessary to complete the sale and a service that is incidental to the sale of tangible personal property.
- The applicability of the sales and use tax to performance contracts and standards for distinguishing between performance contractors and retailers.
- The distinction between food and prepared food under the sales and use tax laws and whether to eliminate this distinction by applying a uniform, revenue-neutral rate to all food.

Procedure for Tax Class Actions. – Section 28.28, which was a recommendation of the Revenue Laws Study Committee, establishes a procedure for taxpayers seeking to initiate or join a class action in order to obtain a refund of tax paid due to an alleged unconstitutional statute. This section became effective October 1, 2008, and applies to civil actions filed on or after that date.

The Revenue Laws Study Committee spent a significant amount of time examining this issue. Prompted by requests from both the North Carolina Bar Association and the North Carolina Association of Certified Public Accountants, the Committee first examined the issue in 2002. The Committee revisited the issue in 2006 as part of its broader, in-depth study of the procedures related to the review of disputed tax matters. Most recently, in its report to the 2008 Regular Session of the 2007 General Assembly, the Committee determined that the existing law needed to be clarified because of ambiguity surrounding recent judicial interpretations of the 'protest statute', which was the prior mechanism for bringing a civil suit for a refund of tax. The purpose of this legislation is to identify and protect the potential liability of the State for tax refunds and to give taxpayers, the Department, and practitioners clear guidance as to the proper procedure governing tax-related class actions.

- **Authority**. – Neither the law prior to 2007, nor the law in place prior to the effective date of this act expressly allows for a class action for the refund of a tax. However, the North Carolina courts have allowed civil actions brought under the former protest statute[185] to be certified as class actions. Effective January 1, 2008, a new statute governs the conditions under which a civil action may be initiated by a taxpayer for the

[185] G.S. 105-267.

refund of a tax based on the alleged unconstitutionality of a statute.[186] However, the statute is silent with regard to class actions. This section provides specific statutory authority for tax class actions, which may be brought only on the grounds of an alleged unconstitutional statute.

- **Bringing a Tax Class Action**. – A taxpayer who wishes to commence a class action challenging the constitutionality of a tax statute and who seeks to represent the class must meet certain requirements. First, the taxpayer must meet the same requirements that any other taxpayer is required to meet in order to bring a civil action. Those requirements are as follows:
    - The taxpayer must receive a final determination from the Department after a review and conference.
    - The taxpayer must commence a contested case at the Office of Administrative Hearings (OAH).
    - OAH subsequently dismissed the case for lack of jurisdiction because the sole issue in the case is the facial constitutionality of a statute.
    - The taxpayer has paid the tax, penalties, and interest due in the final determination.
    - The civil action is filed within two years of the dismissal from OAH.

  Second, the taxpayer must also comply with any requirements under Rule 23 of the North Carolina Rules of Civil Procedure. North Carolina courts have required compliance with Rule 23 in prior tax class actions, so the requirement is not new, but this section sets out the requirement explicitly in statute.

  Finally, this section adds a new requirement for bringing a tax class action. The taxpayer's claims must be typical of the claims of the class members in order for the taxpayer to serve as the class representative. This language mirrors language in Rule 23 of the Federal Rules of Civil Procedure. Whether a claim is 'typical' is an issue for the court to determine when approving the class representative.

- **Joining a Tax Class Action.** – In order to become a member of a tax class action, a taxpayer must be eligible and must affirmatively elect to participate as a member of the class.
    - Eligibility. – A taxpayer is eligible to become a member of the class if the taxpayer could have filed a claim for refund as of the date the class action was commenced or as of a subsequent date set by the court, whether or not the person actually filed a claim. For purposes of determining this eligibility, a class action 'commences' upon the later of the date a complaint is filed alleging the existence of a class or the date a complaint is amended to allege the existence of a class.
    - Affirmative Election. – An eligible taxpayer becomes a member of a class by affirmatively indicating a desire to be included in the class in response to a notice of the class action. A taxpayer who joins a class is not required to exhaust the administrative review process; only the class representative must do so.

[186] G.S. 105-241.17.

- **Procedure. –** The procedure for notifying potential class members, the content of the notice, and the method by which potential class members indicate a desire to be included in the class in response to the notice must be approved by the court. This procedure may include ordering the Department of Revenue to provide the class representative with a list of names and last known addresses of all taxpayers who are readily determinable by the Department and are eligible to become a member of the class. The class representative must advance the costs of notification.

- **Statute of Limitations.** – The general statute of limitations for obtaining a refund of overpayment of tax is the later of three years after the due date of the return or two years after payment of the tax. Without a class action mechanism, each taxpayer seeking a refund of a tax paid under an alleged unconstitutional statute would have to file a claim for refund within the statute of limitations period and exhaust the administrative and judicial review process.

  One general principle of class actions is that the filing of a suit tolls the statute of limitations for all prospective class members until class certification is denied. If certification is denied, the limitations period begins to run again and plaintiffs may file their own individual claims. This same principle applies to tax class actions. The statute of limitations for filing a claim for refund on the grounds of an unconstitutional statute is tolled for a taxpayer who is eligible to become a member of a class action. The tolling begins on the date the class action is commenced. For a taxpayer who does not join the class, the tolling ends when the taxpayer does not affirmatively indicate a desire to be included in the class as provided by the court.

  For a taxpayer who does join the class, the tolling ends when the court enters any of the following:

  - A final order denying certification of the class.
  - A final order decertifying the class.
  - A final order dismissing the class action without an adjudication on the merits.
  - A final judgment on the merits.

- **Effect on Nonparticipating Taxpayers.** – Class actions are designed to adjudicate, in a single action, the claims of numerous parties with similar claims. One objective of a class action judgment is to prevent future litigation of claims that were, or could have been, litigated in the class action. Thus, the legal principles of 'claim preclusion' and 'issue preclusion' arise in the class action context. Claim preclusion means that a final judgment on the merits in a case is conclusive as to the rights of the parties to that case and bars them from bringing a subsequent action involving the same claim. In the class action context, the application of claim preclusion means that the judgment applies to the entire certified class. In certain instances, it can also bind nonparties. It does not, however, bar an individual who elects not to participate in the class action from bringing his or her own claim. Issue preclusion bars the same parties from relitigating in a subsequent action an issue that was litigated in a prior action. Courts have generally held that a successful defendant in a prior class action suit may not assert issue preclusion in a subsequent suit against a plaintiff who opted out of the earlier class action. Similarly, when a class prevails in an earlier action, an individual who opted out of that class who now chooses to bring his or her own individual claim against the same defendant may not assert issue preclusion in that case.

This section provides that the principles of claim preclusion and issue preclusion apply to tax class actions in the same manner in which they apply to class actions generally. It further specifies that if a final judgment on the merits is entered in a class action in favor of the class, the following applies to an eligible taxpayer who did not become a member of the class:

- The taxpayer is not entitled to share in any monetary relief awarded to the class.
- If the taxpayer has been assessed for failure to pay the tax at issue in the class action and the taxpayer has not paid the assessment, then the assessment is abated.
- The taxpayer is relieved of any future liability for the tax that is the subject of the class action.

2008 BUDGET TECHNICAL CORRECTIONS.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-118	**HB 2438**	**Rep. Michaux, Tolson, Yongue**

AN ACT TO MAKE TECHNICAL, CLARIFYING, AND OTHER MODIFICATIONS TO THE STATE BUDGET.

OVERVIEW: Section 3.10 of this act allows an annual sales and use tax refund for materials used to build a facility that manufactures solar electricity generating materials. The remainder of this act does not impact the tax laws and is not discussed below.

FISCAL IMPACT: This section is expected to reduce General Fund revenues by $348,813 in fiscal year 2010-2011.

EFFECTIVE DATE: Section 3.10 of this act became effective July 1, 2008, applies to purchases made on or after that date, and expires for purchases made on or after January 1, 2013.

ANALYSIS: Section 3.10 of this act adds 'solar electricity generating materials manufacturing' to the list of industries entitled to an annual refund of the sales and use tax paid by the owner of the industry on building materials and supplies, fixtures, and equipment used to construct a facility that will be used primarily to manufacture solar electricity generating materials. Solar electricity generating materials manufacturing is defined as the development and production of one or more of the following:

- Photovoltaic materials or modules used in producing electricity.
- Polymers or polymer film primarily intended for incorporation into photovoltaic materials or modules used in producing electricity.

The industries currently eligible for the refund include the following: air courier services; aircraft manufacturing; bioprocessing; computer manufacturing; financial services, securities operations, and related systems development; motor vehicle manufacturing; pharmaceutical and medicine manufacturing and distribution of pharmaceuticals and medicines; and semiconductor manufacturing.

Photovoltaics (PV) are solar cells made and composed of semiconductor materials that are used to convert sunlight directly into electricity. The current solar industry in the United States employs some 20,000 employees in high value, high tech jobs and is expected to grow toward a workforce of 150,000 by the year 2020.[187] DuPont is a materials and technology supplier to the PV industry. It offers products needed for PV module production, such as polymer films, resins, sheets, and conductive pastes. DuPont has one facility in Bladen County and another in Kentucky that produce polymers needed to manufacture polymer film. The company is looking to expand this industry. United Solar Ovonic is a company headquartered in Michigan that specializes in thin film solar technologies and the manufacture of thin film solar electric modules and laminates. It, too, is looking to expand its operations.

To be eligible for this refund, the Secretary of Commerce must certify that the owner of the facility will invest at least $50 million of private funds in the construction of the facility, if the facility is located in a development tier one area, and at least $100 million if the facility is located elsewhere in the State. In addition to the investment requirement, a solar electricity generating materials manufacturing business must also meet a wage standard in order to qualify for the sales tax refund. A business meets the wage standard if it pays the lesser of an average weekly wage that is equal to or greater than 110% of the average weekly wage for the State or the average weekly wage for the county.

If the owner does not make the required minimum investment within 5 years after the first refund is received, the owner forfeits all refunds already received. Upon forfeiture, the owner is liable for not only the tax due, but also interest computed from the date each refund was received. A person that fails to pay the tax and interest due within 30 days after the date of forfeiture is subject to the penalties provided in G.S. 105-236. A request for a refund must be in writing and must be submitted within six months after the end of the State's fiscal year. A refund applied for after the due date is barred. The refund provision expires for purchases made on or after January 1, 2013.

REV LAWS TECH., CLARIFYING, & ADMIN CHANGES.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-134	**SB 1704**	**Senator Hartsell**

AN ACT TO MAKE TECHNICAL, CLARIFYING, AND ADMINISTRATIVE CHANGES TO THE TAX AND RELATED LAWS.

OVERVIEW: This act makes technical, clarifying, and administrative changes to the revenue laws, the motor fuel tax laws, and related statutes, as recommended by the Revenue Laws Study Committee.

FISCAL IMPACT: No impact.

EFFECTIVE DATE: Except as otherwise provided, these changes became effective when the act was signed into law by the Governor on July 28, 2008.

[187] "Energy Alternatives and Jobs." 2000. Renewable Energy World, 3(6): November/December, pp. 26 32.

ANALYSIS:

Part I: 911 Technical Changes

Section	Explanation
1.(a)	Allows the 911 Board to adjust allocations to ensure local governments receive, at a minimum, the same revenues the local government collected in 911 fees for the fiscal year ending June 30, 2007.
1.(b)	Changes from calendar year to fiscal year the time frame in which the Board can make changes in allocation percentages to conform to the Board's accounting practices.
1.(c)	Clarifies that the Eastern Band of the Cherokee Nation is an eligible PSAP and can receive disbursements from the 911 Fund, even though the Nation is exempt from Chapter 159, the Local Government Finance Act. Its per capita distribution amount will be based upon the most recent federal census estimates of the population living on the Qualla Boundary.
1.(d)	Extends the moratorium on the collection of the 911 fee from prepaid wireless providers from the 2008 calendar year to the first nine months of the 2009 calendar year.

Part II: Work Opportunity Tax Credit (WOTC) Changes

2.(a)	Clarifies that the WOTC is limited to 6% of the federal credit for wages paid in the same taxable year for positions located in North Carolina. Places a sunset on the credit effective for taxable years beginning on or after January 1, 2012. These changes are effective for taxable years beginning on or after January 1, 2008.
2.(b) &(c)	Clarifies that an employer cannot deduct the wages paid as a business expense from state taxable income if the employer takes the WOTC for those wages.

Part III: Reform Tax Appeal Changes

3	Conforms the due date of the franchise tax return and the corporate tax return. Section 10 of S.L. 2007-491 extended by one month the due date for filing a franchise tax return. Section 14 of that act made a corresponding change for corporate income tax returns. Since franchise tax and corporate income tax are reported on the same form, the effective dates must conform. However, the way the act was drafted, the one-month extension for franchise tax would occur in 2008 while the one-month extension for corporate income would take place in 2009. This section corrects the inconsistency by repealing Section 10, effective retroactively to January 1, 2008, and by reenacting the provision, effective January 1, 2009. With this change, the one-month extension will take effect for both taxes beginning in 2009. Inserts language inadvertently omitted in a rewrite of the franchise tax statute in 2007. Section 10 of S.L. 2007-491 rewrote for clarity the subsection imposing the franchise tax. The rewrite inadvertently omitted existing language requiring a corporation to determine its tax liability based on "the books and records of the corporation at the close of the income year." This section puts this language back in the statute.

4	Conforms the corporate tax return to the franchise tax return. S.L. 2007-491 added chief financial officers to the list of corporate officers authorized to sign franchise tax returns and deleted the secretary, the assistant secretary, and the assistant treasurer. However, similar changes were not made in the corresponding corporate income tax statute. Since the franchise tax return and the corporate income tax return are on the same form, the statutes need to match. This section makes that conforming change to the corporate tax statute.
5	Provides that a taxpayer may file a request for review of the Department of Revenue's proposed denial of a refund at any time by the date that inaction by the Department is considered a proposed denial of the refund but within 45 days of receiving actual notice of a proposed denial by the Department. This section addresses that concern, as recommended by the Department, and is effective for taxable years on or after January 1, 2008. Under the new administrative review process, the Department of Revenue is required to take action on a request for a refund within six months after the request has been filed. If the Department denies the request, it must send a notice to the taxpayer, and the taxpayer has 45 days to request a review of the proposed denial. However, if the Department fails to take any action within six months, the request is considered denied, and the taxpayer has 45 days from that point to request review. The purpose of this provision is to allow a taxpayer to move forward in the administrative review process despite inaction by the Department. However, concerns have been raised that the running of this 45-day period without actual notice from the Department may create a potential trap that bars taxpayers from appealing the denial.
6	Clarifies that the validity of a proposed denial of refund is not affected by the Department's failure to timely issue a notice of final determination. The Department must issue a final determination within nine months after the taxpayer requests a review of a proposed denial of a refund or a proposed assessment of tax. The relevant statute specifically provides that failure to timely issue a notice of final determination does not affect the validity of a proposed assessment but is silent as to the impact on a proposed denial of refund.
7	Replaces the word 'tax,' which is a defined term, with the word 'amount' for consistency. The purpose of this change is to clarify that if a taxpayer does not send in the amount shown due with a return, the Department can collect the principal amount of the tax, any applicable penalties, such as failure to pay, and interest.
8	Makes a conforming change in the motor fuel tax law regarding the new administrative review process.

9	Allows government agency lab reports to be admitted into evidence in a contested tax case hearing without requiring agency personnel testimony. S.L. 2007-491 made special provisions for contested tax cases heard at the Office of Administrative Hearings. Among them, a law enforcement report may be admitted into evidence without the testimony of personnel from the law enforcement agency. The Motor Fuels Tax Division of the Department requested a similar provision for government agency lab reports used in the enforcement of the motor fuel tax laws.

Part IV: Collection Changes

10	Adds partners and managers of a partnership (who may or may not be a partner) to the list of officers or, as rewritten, 'responsible persons' whom the Department may assess. The Department requested this change. This section also rewrites the section for clarity and style and places the statute in a more logical location within the Article. Individual officers and directors of a corporation are usually not liable for corporate debts or obligations. This is in contrast to partnership debts and liabilities, which are chargeable personally to the individual partners. However, by statute, a 'responsible officer' of a corporation or a limited liability company may be held personally liable for certain unpaid trust taxes owed by the business entity. These taxes include sales and use, motor fuels, and income withholding taxes. A 'responsible officer' is defined as the president, treasurer, and the CFO of a corporation, the manager of a LLC, and any other officer of a corporation or a member of a LLC who has a duty to pay taxes on behalf of the entity. The Department is authorized to enforce collection by proposing an assessment against the officer. Under prior law, there was no similar statutory authorization to assess partners for these taxes. Instead, the Department, like any other creditor of a partnership, would be required to sue in order to collect this liability. Once a judgment was obtained, the Department could seek to execute the judgment. This section became effective July 1, 2008, and applies to taxes that become collectible on or after that date.

Part V: Sales Tax Changes

11	Specifies how the tax on gross receipts from periodic payments made pursuant to agreements entered into before the effective date of the sales tax rate changes is to be reported. This section is a transitional provision for the 'Medicaid swap' enacted in the 2007 Session by S.L. 2007-323. Under the swap, the local sales and use tax rate decreases by ¼ cent in 2008-09 and again in 2009-10, and the State sales and use tax rate increases by the same amount. The combined State and local rates do not change; instead, the allocation of the combined rate between the State and the counties changes. Periodic payments consist of lease and rental payments and installment sale payments. Sales and use tax is due on lease and rental payments when the payments are billed. For installment sales, the tax application

	differs depending on whether the retailer reports on an accrual basis or a cash basis. A retailer on an accrual basis reports all the sales tax due on an installment sale when the sale is made. A retailer on a cash basis reports sales tax when each installment payment is received. This provision requires retailers who receive periodic payments from existing contracts to report them at the current State and local rates. This eliminates confusion about what to report and how to report it. Without this provision, a retailer who receives periodic payments will have receipts from existing contracts that are reportable at State and local rates that differ from the State and local rates that apply to periodic payments from new contracts.

Part VI: Occupancy Tax Changes

12.(a)	Provides that an interpretation by the Department of Revenue of a State sales tax law provision applies to a local law that references that provision. As the result of an independent audit by at least one county, questions arose among local governments and within the tourism industry regarding what constitutes 'gross receipts' for occupancy tax purposes. Most local occupancy tax acts state that a county or city may levy a room occupancy tax on "the gross receipts derived from the rental of any room…that is subject to sales tax imposed by the State under G.S. 105-164.4(a)(3)." Therefore, if an item of tangible personal property or a fee associated with the rental of an accommodation is subject to sales tax under G.S. 105-164.4(a)(3), then it is also subject to the local occupancy tax. While the Department can offer an interpretation of the State sales tax laws, it does not have statutory authority to offer an interpretation of the application of local occupancy tax laws, which it does not administer.
12.(b) & (c)	Provides that collectors of occupancy tax may allocate revenues for vacation packages that do not otherwise meet the definition of a bundled transaction. In January of 2008, the Department issued a technical bulletin related to the rentals of accommodations. In that bulletin, the Department clarified that the bundling provisions in G.S. 105-164.4D apply to vacation packages. For example, a vacation package may include lodging, meals, and greens fees for one price. The lodging is subject to sales and local occupancy tax, the meals are subject only to sales tax, and the greens fees are not subject to either sales or occupancy tax. The bundling provisions allow a hotel operator to allocate the revenues between taxable and exempt portions of the package. The allocation may be part of a hotel's internal records and is not required to appear on the customer's bill. A 'bundled transaction' is defined as a sale that includes at least one taxable item and at least one exempt item. Since the release of the bulletin, the tourism industry has sought clarification of whether the allocation rules apply to vacation packages consisting only of taxable items, since those packages do not otherwise meet the definition of a bundled transaction. The clarification is needed because although the entire vacation package may be subject to sales tax, not all items may be

	subject to occupancy tax. The collectors would like the ability to allocate those revenues.

Part VII: Medicaid Technical Changes

13	Ensures that counties spend as much on public school capital outlay as they would have in the absence of the Medicaid swap. Part of the swap changes the distribution of taxes imposed under Article 42 from a per capita basis to a point of collection basis. A county whose sales tax revenue decreases as a result of this conversion is required to continue to fund public school capital outlay at the amount that would be required in the absence of the conversion.
14	Makes two clarifying changes to the hold harmless calculation. The first is a technical change that describes the hold harmless calculation in a way that does not require a reference to local sales taxes on food. The change in the description does not change the amount of the hold harmless. The local sales taxes on food are administered as if they were State taxes and are included, in part, in the amount distributed under Article 40 but are not part of the amount allocated under G.S. 105-486. The second change eliminates a potentially circular calculation of the amount of local sales and use tax revenue to be distributed. It does not change the amount of any tax or hold harmless payment. The prior law could be construed to calculate the amount of various hold harmless payments on the basis of an amount that includes a deduction for the payment that is attempted to be calculated, which is circular. The hold harmless payments are now both pegged, in part, on amounts distributed under Article 39 of Chapter 105 of the General Statutes and deducted from those amounts. This section resolves the problem by making it clear that the hold harmless payments are calculated on the basis of amounts allocated for distribution before any subtraction for the hold harmless payments. References in Article 39 and Chapter 1096 of the 1967 Session Laws are replaced with a direction in G.S. 105-522(b) to deduct the city hold harmless payment from the amount of local sales and use tax revenue otherwise allocated under those provisions for distribution to a county. Subsection (a) adds an instruction in G.S. 105-522(b) to deduct the payment. Subsection (b) removes the instruction from Article 39 of Chapter 105. Subsection (c) removes the instruction from Chapter 1096.
15	Makes three changes to the hold harmless calculation. First, it inserts the city hold harmless amount into the calculation of the county hold harmless payment, thereby ensuring that the intent of the General Assembly is fulfilled. G.S. 105-523(a) states that each county is to benefit from the Medicaid swap by at least $500,000. The current calculation for determining a county's hold harmless payment, however, does not include the amount a county is required to give to its cities in order to hold them harmless from the repealed local sales taxes. Subsection (a) adds the cost of the city hold harmless to the calculation of the county hold harmless payment. Subsections (d) and (f) repeal changes to G.S. 105-523 that were to take effect in 2009, and subsection (h) reinserts those same

	changes into the amended G.S. 105-523 while preserving the amendments added by subsection (a) Second, it makes the same technical change to G.S. 105-523(b)(3) that Section 14 makes to G.S. 105-522(a)(2). The technical change describes the hold harmless calculation in a simpler way that does not require a reference to local sales taxes on food. The change in the description does not change the amount of the hold harmless. The local sales taxes on food are administered as if they were State taxes and are included, in part, in the amount distributed under Article 40 but are not part of the amount allocated under G.S. 105-486. Third, it changes the city hold harmless formula and the county hold harmless formula that apply to fiscal years beginning in 2009-2010 to match these formulas to the ones used in the tables that calculated the impact of the swap. The prior law incorrectly included a ¼% tax distributed on the basis of point of origin as one of the elements of the formulas. The Medicaid swap is based on the repeal of ½% local sales and use taxes distributed on a per capita basis and the conversion of a ¼% per capita tax to a ¼% point of origin tax. To reflect this, the reimbursement formula needed to be changed to delete the reference to a ¼% point of origin tax and replace it with a ¼% per capita tax. Subsections (c), (d), and (f) of this section repeal the provisions that contain the incorrect reference and subsections (g) and (h) insert the correct reference in the formulas. Subsections (b), (e), and (i) make conforming changes; they repeal sections that use terminology that does not match the revised reimbursement sections and replace them with a provision that uses terminology that is consistent with the revised sections.

Part VIII: Motor Fuel Tax Law Changes

The changes made by this part are effective January 1, 2009.

16	Makes clarifying and conforming changes and numbers the definitions sequentially. Adds definitions for terms used in the motor fuel tax statutes. Under IFTA, a 'qualified motor vehicle' is one used, designed, or maintained for transportation of persons or property that meets one or more of the following conditions: has two axles and a gross vehicle weight or registered gross vehicle weight exceeding 26,000 pounds; has three or more axles regardless of weight; or has a gross vehicle weight or registered gross vehicle weight exceeding 26,000 pounds when it is combined with another vehicle
17	Corrects a punctuation error.
18	Changes the statute to reflect current practice. Provides that the Department may include information received from the State Highway Patrol when determining the potential liability of a motor carrier. The SHP used to be located within the DMV. Incorporates defined terms.

19	Incorporates defined terms. Clarifies that recreational vehicles that are qualified motor vehicles under the IFTA would need to be registered. Also, the use of the defined term 'qualified motor vehicle' means that special mobile equipment would need to be registered. Although the law's definition of 'motor vehicle' arguably included special mobile equipment, the Department has not been requiring the registration of special mobile equipment. However, other IFTA states do require the registration of special mobile equipment.
20	Incorporates the commonly used term 'decal' for 'identification marker'.
21	Repeals an unnecessary statute. G.S. 105-252 and G.S. 105-254 give the Secretary the authority to prepare the appropriate forms and require the necessary information on those forms.
22	Incorporates the commonly used term 'decal' for 'identification marker'. Modernizes the language.
23	Incorporates the commonly used term 'decal' for 'identification marker'.
24	Revises the definitional statute to define commonly used terms, to incorporate definitions from other statutes, and to refer to federal regulations. It numbers the definitions sequentially.
25	Incorporates into the licensing statute the requirement that a for hire transporter have a license and specifies that a biodiesel provider is not required to have a separate license as a blender.
26	Makes conforming and grammatical changes. It removes definitions that have been incorporated into the definitional statute and it corrects the spelling of the term 'bulk end-user'.
27	Corrects the spelling of the term 'bulk end-user'.
28	Incorporates the defined term 'supplier'.
29	Incorporates the defined term 'in-State supplier'.
30	Provides that an importer's license must indicate the category of the importer, just like a supplier's license must indicate the category of the supplier.
31	Clarifies the payment responsibilities of all license holders.
32	Specifies when the tax is payable on fuel grade ethanol. Effective January 1, 2009, the tax is payable when it is removed from a terminal or is produced in the State or imported to the State and not delivered to a terminal. Under law, it is taxable when it is blended. Specifies that a tax is payable when motor fuel is transferred 'behind-the-rack' to a person who is not licensed as a supplier, as required by law.
33	Provides that the supplier who sold motor fuel to an unlicensed exporter is jointly and severally liable for the tax imposed on that fuel. The statute provides similar joint and several liability for motor fuel sold to an unlicensed distributor; for motor fuel sold by an unlicensed supplier; and for dyed diesel fuel.

34	Makes a conforming change to the change made in Section 32 concerning taxation of fuel grade ethanol.
35	Makes a conforming change to the change made in Section 32 concerning transfers to unlicensed persons.
36	Corrects a grammatical error.
37	Corrects the spelling of the term 'bulk end-user'.
38	Corrects the spelling of the term 'bulk end-user' and 'end-seller'.
39	Corrects the spelling of the term 'bulk end-user'. Prohibits a supplier from transferring motor fuel from a terminal to a marine vessel unless the person to whom the fuel is transferred is a licensed supplier.
40	Identifies the tax responsibility of purchasers to the supplier.
41	Removes the requirement to sort the fuel by type on the reporting form; the requirement is not longer necessary due to electronic filing. It provides the Department with the ability to sort.
42	Corrects the spelling of the term 'bulk end-user'.
43	Makes a conforming change to administrative practice. It provides that terminal operators who are required to be licensed in this State must report transactions from out-of-state terminals with this State as its destination. It also changes the structure of the statute for uniformity purposes.
44	Requires only motor fuel transporters who transport motor fuel for hire to file reports of fuel movements. This reverses a change made last year that required all distributors and others who transport motor fuel for themselves and not for hire to file the reports.
45	Changes the structure of the statute for uniformity purposes.
46	Changes the catchline of the statute to more accurately reflect the contents of the statute. It specifies that the refunds are monthly refunds; this change reflects current practice. It also provides that an out-of-state bulk end-user must be registered as an exporter if requesting a refund for exports from a North Carolina bulk plant.
47	Specifies that the refund is a monthly refund; this change reflects current practice.
48	Corrects the spelling of the term 'end-user'.
49	Deletes the provisions for refunds filed upon application because all refunds are filed on an annual basis, a quarterly basis, or a monthly basis.
50	Clarifies the content of the shipping document.
51	Makes a conforming change to administrative practice and terminology.
52	Uses the defined term 'person'; that term incorporates a distributor.
53	Corrects the spelling of the term 'bulk end-user'. Cross-references the definition of highway to the defined term in the definitional statute.

54-58	Corrects the spelling of the term 'bulk end-user'.
59	Cross-references the defined terms in the definitional statute and renumbers the subdivisions sequentially.
60	Makes a conforming change to add the defined terms of aviation gasoline and jet fuel to the statute that imposes the ¼-cent inspection tax and provides that the tax on these two types of fuel are payable as specified by the Secretary of Revenue.

Part IX: Combined Motor Vehicle and Property Tax Registration System

61	Repeals current statutory provisions on the required memorandum of understanding because they are recodified in G.S. 105-330.11 as enacted by § 64 of this act.
62	Clarifies that an application for property tax exemption or exclusion is not required for vehicles qualifying for an exemption or exclusion listed in G.S. 105-282.1(a)(1). This change prevents the need to apply for an exemption for government owned vehicles and vehicles listed as inventory.
63	Clarifies the statute. Directs the Treasurer to report to Revenue Laws annually instead of semiannually.
64	Recodifies the provisions on the memorandum of understanding required between the Departments of Revenue and Transportation with respect to implementation of the combined collection system for vehicle registrations and property taxes.
65, 66	Delays the effective date of the combined system from July 1, 2010, to July 1, 2011.

Part X: Other Changes

67	Removes a provision that refers to a repealed statute for subdivision.
68	Allows an unauthorized substance tax officer to testify in court concerning an offense committed against that individual in the course of administering the Article. Currently, information obtained under Article 2D (Unauthorized Substance Taxes) is confidential and may not be disclosed, unless the disclosure is made to exchange information with certain law enforcement agencies concerning a tax imposed by the Article. The information may also not be used in a criminal prosecution, other than for a prosecution for a violation of the Article or unless the information is independently obtained. The Department requested this change due to a specific incident involving an officer who was assaulted but was prohibited from testifying about the incident.
69	Corrects an incorrect citation.
70	Clarifies a reference to a 'year' in a tax credit statute is a reference to a 'taxable year.'

71	Codifies the long-standing practice of the Department that it is able to correct errors concerning a taxpayer's liability whenever they are brought to the Department's attention.
72	Makes a clarifying change to the property tax exemption for historic preservation property.
73	Repeals the North Carolina Rural Redevelopment Authority (NCRRA). The NCRRA is an inactive entity. It was created by S.L. 2000-148 but was never appointed or funded. Creation of the Authority was a recommendation of the 1999 North Carolina Rural Prosperity Task Force, which was established by Governor Jim Hunt and chaired by Erskine Bowles. As envisioned by the Task Force, the Authority would administer a revolving loan fund, the Rural Investment Fund, as well as an investment fund, the Long-Term Rural Development Fund. No money was ever appropriated to these funds. Subsection (a) repeals the statutes that create the Authority and set out its duties. Subsections (b) through (e) make conforming changes. Specifically, subsection (b) repeals the Authority's exemption from the general prohibition against a State agency competing with private enterprise. Subsection (c) deletes the Authority from the list of boards and commissions on which legislators may not serve. Subsection (d) repeals the Authority's exemption from the State Personnel Act. Subsection (e) changes a cross-reference to a definition of regional partnership that is now set out in a statute that is repealed in subsection (a); it replaces the cross-reference with the substance of the definition and updates the definition to reflect the accurate names of the regional economic development partnerships.
74	Clarifies that the ½% sales tax for transit purposes authorized for Mecklenburg County exempts purchases of food.
75	Corrects a statutory reference.
76	Provides for the proration of taxation when property in a county law enforcement service district is annexed by a municipality.
77	Corrects proper name of one of the regional partnerships.
78	Provides that information concerning tax credits may be provided to consultants for the Joint Select Committee on Economic Development Incentives to compile statistical data. The consultants are employees of the University of North Carolina at Chapel Hill and are subject to the same confidentiality requirements as an employee of the State of North Carolina.

TAX ON SHORT-TERM HEAVY EQUIPMENT RENTALS.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-144	**SB 1852**	**Senator Brunstetter**

AN ACT TO RESOLVE PROBLEMS WITH APPLYING PROPERTY TAX TO HEAVY EQUIPMENT RENTED ON A SHORT-TERM BASIS BY REPLACING THE PROPERTY TAX ON THIS EQUIPMENT WITH A TAX ON THE GROSS RECEIPTS FROM RENTING THE EQUIPMENT.

OVERVIEW: This act replaces the property tax on certain heavy equipment that is offered at retail for short-term lease[188] or rental with a local option gross receipts tax for certain heavy equipment that is offered at retail for short-term lease or rental.

FISCAL IMPACT: No General Fund impact. The act is revenue neutral for local governments overall, however, individual jurisdictions will experience changes in revenue depending on where sales occur.

EFFECTIVE DATE: The property tax exemption for heavy equipment becomes effective for taxes imposed for taxable years beginning January 1, 2009. A local option gross receipts tax on heavy equipment may not become effective before January 1, 2009.

ANALYSIS: This act excludes from property tax certain heavy equipment that is offered at retail for short-term lease or rental, if the heavy equipment is leased or rented by a person whose principal business is the short-term lease or rental of heavy equipment, effective for taxes imposed for taxable years beginning on or after January 1, 2009. It replaces the property tax on heavy equipment with a local option gross receipts tax. A local option tax may not become effective before January 1, 2009. The act clarifies that short-term heavy equipment is exempt from property tax regardless of whether a county or city imposes a gross receipts tax. In recent years, several owners of heavy equipment rental businesses expressed concerns about the unfairness and administrative inconsistencies of levying and collecting property tax on this equipment.

The local option tax applies to the gross receipts derived from the short-term rental or lease of earthmoving, construction, or industrial equipment that is mobile, weighs at least 1,500 pounds, and meets one or more of the following requirements:

- It is a self-propelled vehicle that is not designed to be driven on a highway.
- It is industrial lift equipment, industrial material handling equipment, industrial electrical generation equipment, or similar piece of industrial equipment.

The gross receipts tax rate that may be imposed by counties is 1.2% and the rate that may be imposed by cities is 0.8% for a combined rate of 2.0% if the heavy equipment rental business is located in a city. The gross receipts are subject to the local tax only if they are subject to the sales tax.

The gross receipts tax is paid quarterly and is due on the last day of the month following the end of the quarter. The tax is sourced based on the place from which the equipment is delivered and is intended to be added to the amount charged for the rental and paid to the heavy equipment business by the lessee.

The Department of Revenue is authorized to disclose otherwise confidential taxpayer information to counties and cities when it relates to the administration of the heavy equipment rental tax.

PROPERTY TAX MODIFICATIONS.

Session Law	*Bill #*	*Sponsor*

[188] A short-term lease is a lease or rental for a period of less than 365 days. (G.S. 105-187.1). Under current law, a long-term lease agreement generally requires the lessee to list and pay the property taxes due on the heavy equipment.

S.L. 2008-146, as amended by S.L. 2008-187[189] **SB 1878** **Senator Clodfelter**

AN ACT TO MODIFY THE SCHEDULE FOR GENERAL REAPPRAISALS OF REAL PROPERTY IN THE STATE TO REDUCE THE DISCREPANCY BETWEEN THE PROPERTY TAX VALUE OF PROPERTY AND ITS MARKET VALUE, TO MODIFY THE OWNERSHIP REQUIREMENTS OF PRESENT-USE VALUE PROPERTY TO REFLECT COMMON FORMS OF LAND OWNERSHIP, TO ALLOW PROPERTY TO REMAIN IN PRESENT-USE VALUE WHEN THE DEFERRED TAXES ARE PAID AT THE TIME OF TRANSFER AND THE NEW OWNER CONTINUES TO FARM THE PROPERTY, TO CLASSIFY LOW-INCOME HOUSING PROPERTY, TO EXCLUDE FROM PROPERTY TAX PRESCRIPTION DRUGS GIVEN AS FREE SAMPLES, TO EXCLUDE FROM PROPERTY TAX EIGHTY PERCENT OF THE APPRAISED VALUE OF A SOLAR ELECTRIC SYSTEM, AND TO DIRECT THE REVENUE LAWS STUDY COMMITTEE TO STUDY THE EFFECT THAT THIS ACT HAS ON STAFFING NEEDS OF THE DEPARTMENT OF REVENUE AND THE DEFINITION OF INCOME AS IT APPLIES TO THE HOMESTEAD EXCLUSION.

OVERVIEW: This act makes the following changes to the property tax laws:

- Part I of the act retains the octennial schedule for reappraisal of real property but requires counties with a population of 75,000 or greater to advance the general reappraisal if the sales assessment ratio for the county drops below .85 or becomes greater than 1.15.[190] This part becomes effective July 1, 2009.
- Part II of the act modifies the present-use value ownership requirements to reflect modern estate planning and allows property to remain in present-use value when deferred taxes are paid at the time of transfer and the new owner continues to farm the land and files an application for present-use value status. This part is effective for taxable years beginning on or after July 1, 2008.
- Part III of the act classifies qualified North Carolina low-income housing developments as a special class of property and requires valuation of the property to be based on the actual (rent-restricted) income. This part is effective for taxes imposed for taxable years beginning on or after July 1, 2009.
- Part IV of the act exempts from property tax free samples of prescription drugs given to physicians and other medical practitioners to dispense free of charge in the course of their practice. This part is effective for taxable years beginning on or after July 1, 2008.
- Part V of the act excludes 80% of the appraised value of a solar energy electric system from property tax. This part of the act is effective for taxable years beginning on or after July 1, 2008.

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[189] Section 47.6 of S.L. 2008-187, the 2008 technical corrections bill, eliminates a codification conflict created in House Bill 1889 and Senate Bill 1878.

[190] The Senate version of SB 1878 required counties to advance the general reappraisal if the sales assessment ratio for the county dropped below .90 for the previous year. The House version required counties to advance the general reappraisal if the sales assessment ratio for the county dropped below .70 or became greater than 1.10 for the previous year. The conference report required the advanced general reappraisal only for a county whose population is 75,000 or greater and when the county's sales assessment ratio dropped below .85 or became greater than 1.15.

- Part VI of the act directs the Revenue Laws Study Committee to study the following: whether the Department of Revenue needs positions to perform sales assessment ratio studies in additional counties and other functions related to the act, and the definition of income as it applies to the homestead exclusion. This part became effective when the act was signed into law by the Governor on August 2, 2008.

FISCAL IMPACT: There is minimal impact on local government revenue associated with the changes to the reappraisal schedule, the PUV ownership requirements, the property tax exemption for sample prescription drugs, and the partial property tax exclusion for solar energy electric systems. The valuation change for low-income housing is estimated to reduce local government revenues by $21 million. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2008 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: See **OVERVIEW.**

ANALYSIS: The act makes the following changes to the property tax laws:

Part I: Reappraisal Schedule

Counties are required to reappraise real property at least once every eight years. The law allows counties to advance the octennial schedule by adopting a shorter cycle, such as every four or six years. Each year, the Department of Revenue studies property values in every county and compares the value of the parcels as a function of their sales price with the value of the parcels as indicated by their assessed tax value. The Department notifies each county of the resulting sales assessment ratio on April 15 of the year following the study.

The act requires a county with a population of 75,000 or greater to advance its octennial reappraisal schedule if its sales assessment ratio drops below .85 or becomes greater than 1.15 in the previous year.[191] This change would occur when the assessed value differs from the sales price of the property by more than 15%. A county required to conduct a new reappraisal under this act must implement the new values by January 1 of the third year following the year the notification of the triggering sales assessment ratio was made. The act retains the octennial reappraisal schedule for all other counties. This part of the act becomes effective July 1, 2009, and applies to notices sent on or after that date.

The genesis for this Part came from a recommendation of the Revenue Law Study Committee. The act directs the Revenue Laws Study Committee to study the effect of the changes to the reappraisal schedules in this Part. Its study of the issue should consider whether new positions within the Department of Revenue are needed to perform sales assessment ratio studies in additional counties each year. This directive to the Committee was prompted by concerns raised by some of the smaller counties regarding whether they could handle the expense of more frequent reappraisals.

Part II: Present-Use Value Property Changes

Part II of the act makes changes to the present-use value (PUV) program, as recommended by the Revenue Laws Study Committee. These recommendations were proposed to the Committee by representatives of county tax assessors, the North Carolina Association of County

[191] According to the most recent annual population estimates as certified by the State Budget Officer, each of the following counties has a population of 75,000 or greater: Alamance, Brunswick, Buncombe, Burke, Cabarrus, Caldwell, Catawba, Cleveland, Craven, Cumberland, Davidson, Durham, Forsyth, Gaston, Guilford, Harnett, Henderson, Iredell, Johnston, Mecklenburg, Moore, Nash, New Hanover, Onslow, Orange, Pitt, Randolph, Robeson, Rockingham, Rowan, Union, Wake, Wayne, and Wilson.

Commissioners, the UNC School of Government, the North Carolina Farm Bureau, and the Department of Revenue. The changes are effective for taxes imposed for taxable years beginning on or after July 1, 2008.

The General Assembly created the PUV program in 1973. The program provides that farmland meeting certain ownership, size, and use requirements will be provided special property tax treatment.[192] The land is appraised and taxed at its PUV as opposed to its fair market value.[193] The difference between the taxes due on the PUV and taxes that would have been payable in the absence of the special tax treatment is known as 'deferred taxes'. When the land no longer qualifies for PUV treatment, the taxpayer is liable for the property taxes due in the year of disqualification plus the deferred taxes for the three previous years, with interest.[194]

In recent years, taxpayers as well as county tax assessors have voiced concerns about the complexities of the ownership requirements, and taxpayers have raised concerns about the perceived unfairness of these requirements. For example, qualifying land had to be individually owned, which meant that the land could be owned by a natural person, a business entity, a tenancy in common, a trust or a testamentary trust. If the land was owned a business entity or trust, all members of the business entity had to be natural persons, and beneficiaries of a trust had to be natural persons. If the land was owned by tenants in common, then a tenant in common could be a natural person or a business entity but not a trust. These restrictions did not allow for the use of modern estate planning vehicles such as a family limited partnership or family limited liability company. There was also no rationale for excluding certain trusts as a tenant in common.

The act addresses some of these concerns by changing the definition of 'individually owned' as follows:

- The awkward reference to 'owned by a natural person' is changed to 'owned by an individual'.
- Members of a business entity are no longer restricted to individuals and now include trusts and other business entities. A qualified business entity, however, may not be a corporation whose shares are publicly traded and none of its members may be

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[192] The farmland must be used for agricultural, horticultural, or forest purposes and be engaged in commercial production under a sound management program. Agricultural and horticultural land are also required to have one tract that produces at least $1,000 average gross income for the three years preceding the year the tax benefit is claimed. During the 2007 Session, the agricultural land classification was amended to include agricultural land used as an aquatic species farm, effective in the 2008-2009 tax year. During the 2008 Session, the PUV statutes were amended to allow property appraised at PUV and subject to a conservation easement to continue to qualify for use value appraisal if the taxpayer received no more than 75% of the fair market value of the donated property as compensation. Also wildlife conservation land was designated a special class of property for property tax purposes and authorized to be appraised and taxed as if it were classified as agricultural land under the PUV system. See S.L. 2008-171

[193] PUV is usually much less than market value.

[194] No deferred taxes are due if the property loses its classification for one of the following purposes: (1) the land is enrolled in the federal Conservation Reserve Program and is no longer in production and therefore does not meet the income requirement, (2) the land is conveyed by gift to certain exempt organizations and governmental entities. This applies to conveyances by gift to nonprofit organizations where the property will qualify for exclusion from the tax base because it is real property that will be exclusively used for educational and scientific purposes as a protected natural area, or where the property will be exclusively used for nonprofit historic preservation purposes, or (3) the property is conveyed by gift to the State, political subdivisions of the State, or the United States.

corporations whose shares are publicly traded. When the membership of a business entity includes a business entity or a trust, then all members of the business entity and all beneficiaries of the trust must be individuals. These individuals are deemed to be indirect members of the qualified business entity.[195] The law continues to require the principal business of the business entity to be in agriculture, horticulture, or forestry, and each member must be actively engaged in one of these activities or related to a member who is actively engaged in one of these activities. Also, if the land is leased, all members of the business entity must be individuals and relatives.

- Beneficiaries of a trust may be a business entity as long as the members of the business entity are individuals who either created the trust or who are relatives of the creator. These individuals are deemed to be indirect beneficiaries.
- A tenant in common may include a trust in addition to an individual and business entity.

The following are examples of land that now qualify for PUV under the act, but would not have qualified under the prior law:

- A corporation applies for PUV. Four shareholders of the corporation are individuals who are actively engaged in farming the land and one shareholder is an LLC. The members of the LLC are all relatives of one of the individual shareholders. Under prior law, the corporation would not qualify because it has an LLC as a member.
- A tenancy in common applies for PUV, and one of the tenants is a trust. Under prior law, the property would not qualify because all tenants were required to be individuals or business entities.
- An LLC applies for PUV, and one of the members of the LLC is a trust. All beneficiaries of the trust are children of the individual members of the LLC that owns the land. Under prior law, the LLC would not qualify because the trust was not an individual.

There has been a long-standing exception to the standard ownership requirement that a person must own the land for four years. Under the exception, land may continue to be appraised at its PUV value when it is transferred to a new owner and the new owner (i) continues to use the land for its current PUV classification, (ii) files an application for PUV, and (iii) assumes the deferred taxes. This exception has been interpreted not to apply when the seller pays more than the current year's taxes at the time of transfer. In this situation, the seller is deemed to have voluntarily removed the property from the PUV program, and the new owner may have to wait four years to qualify for PUV. The act allows the land to remain in PUV when the deferred taxes are paid at the time of transfer. The new owner will become liable for subsequent deferred taxes when the land no longer qualifies for the PUV program.[196]

Part III: Low-Income Housing Property

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[195] The indirect ownership determination does not stop at the first tier of the business entity that owns farmland. For example, if a business entity has as one of its members an LLC and one of the members of the LLC is another LLC, then the indirect ownership will apply to any member of the second LLC if the member is an individual who is actively engaged in farming the land or a relative of an individual who is actively engaged in farming the land.

[196] See Section 2.2 of S.L. 2008-35.

Part III of the act provides an additional property tax incentive for owners of low-income housing developments to which the North Carolina Housing Finance Agency has allocated a federal tax credit, effective for taxes imposed for taxable years beginning on or after July 1, 2009. Under prior law, an assessor appraised low-income qualified property using one of the following three generally accepted methods of appraisal:

- Cost approach - estimates property value by summing the land value and the depreciated value of any improvements.
- Income approach - estimates value by capitalizing an income stream into present value through the use of capitalization rates of the net operating income[197] which is usually by dividing the annual NOI by the capitalization rate.
- Sales comparison approach – estimates value by comparing a property's characteristics with those of comparable properties which have recently sold in similar transactions.

The act requires the assessor to use the income approach to determine the tax value of property allocated housing tax credits. The tax assessor must take into account any applicable rent restrictions and may not include tax credits as income of the property if those credits result from section 42 of the Internal Revenue Code or G.S. 105-129.42. In so doing, the property value determination is constrained solely to the use of the actual rental income as opposed to what a similarly situated property would be able to generate in rental income if the property were not subject to rent restrictions.

In 1986, Congress enacted the federal Low Income Housing Tax Credit to fund housing for low- and moderate-income households. Each state receives a limited amount of credit each year. The Internal Revenue Service (IRS) allocates the per capita low-income housing tax credit to state housing agencies such as the North Carolina Housing Financing Agency (HFA), which in turn allocate the credit to project developers who agree to lower project rents for low-income tenants. In 1999, North Carolina authorized a State income tax credit modeled after the federal housing credit. The State credit permits a taxpayer to receive the credit in the form of either (i) a credit against tax liability or (ii) a loan generated by transferring the credit to the HFA in return for a 0% interest 30-year balloon loan equal to the credit amount.[198] Neither a tax refund generated by the credit, nor a loan received as a result of the transfer of the credit is considered taxable income by the State.

Part IV: Prescription Drugs Given as Free Samples

Part IV of the act exempts from property tax free samples of drugs that are required by federal law to be dispensed only on prescription and are given to physicians and other medical practitioners to dispense free of charge in the course of their practice, effective for taxable years beginning on or after July 1, 2008. Under prior law, drug samples in doctors' offices were treated as business personal property or supplies and subject to property tax. These drug

[197] The capitalization rate is a measure of the ratio between the cash flow produced by an asset and either the price paid for the asset or its current market value. The Net Operating Income (NOI) equals gross potential income minus vacancy minus operating expenses (excluding debt service or depreciation charges).

[198] Owners of all but one of the 51 rental developments awarded federal credits in 2003 elected to use the State credit as part of their funding. All 50 project developers chose the loan option.

samples do not come under the definition of inventory, which is exempt from property tax, because they are not goods held for sale in the regular course of business.

Part V: Solar Energy Electric Systems

Part V of the act exempts 80% of the appraised value of a solar energy electric system from property tax, effective for taxable years beginning on or after July 1, 2008. A solar energy electric system converts solar energy into electricity.[199] Currently, there are no solar energy electric systems being taxed. However, there are plans to construct a massive solar power plant in Davidson County which is expected to provide enough power for 2,600 homes. Also, two systems were built this year in Asheboro and Raleigh.

North Carolina provides other tax incentives for solar energy. G.S. 105-277(g) designates buildings equipped with solar energy heating and cooling systems as a special class of property and, for property tax purposes, assesses the buildings as if they are equipped with a conventional heating or cooling system rather than assign an additional value for the difference in cost between the solar energy or cooling system and a conventional system typically found in the county.[200] G.S. 105-129.16A and G.S. 105-129.16H provide an income tax credit for investing in renewable energy property, which would include a solar energy electric system. The credit is equal to 35% of the cost of the property placed in service. For non-residential property the maximum credit is $2.5 million per installation.

ECONOMIC DEVELOPMENT MODIFICATIONS.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-147	**SB 2075**	**Senator Berger of Franklin**

AN ACT TO CLARIFY QUALIFICATIONS FOR THE EXCEPTION FOR MULTIJURISDICTIONAL INDUSTRIAL PARKS TIER DESIGNATION AND TO PROVIDE FOR A TEMPORARY INCREASE IN THE CAP ON AMOUNTS COMMITTED UNDER THE JOB DEVELOPMENT INVESTMENT GRANT PROGRAM.

OVERVIEW: This act clarifies that the sale of parcels of land from a multijurisdictional industrial park (MIP) for industrial or commercial purposes does not change the original tier status of the MIP or the availability of the incentives to successive purchasers based on its original tier status. It also increases the cap on amounts committed under the Job Development Investment Grant Program (JDIG).

FISCAL IMPACT: The total maximum cost of increasing the JDIG cap will be $120 million, or $10 million per year for the next 12 years. This estimate assumes that the maximum amount of total annual liability is awarded.

EFFECTIVE DATE: This act became effective when signed by the Governor on August 2, 2008.

ANALYSIS: Any two or more units of local government may enter into contracts or agreements to jointly undertake the development of an industrial or commercial park or site. The lowest development tier incentive status is granted to the entire MIP, regardless of the tier designation of each individual county, if certain criteria are met. One of the criteria is that there

[199] S.L. 2007-307 requires utilities to provide a designated amount or percentage of power from renewable energy resources as a portion of their overall provision of electricity.
[200] This classification does not include solar energy electric systems.

be 250 developable acres in each county where the park is located. As a county sells property in the MIP to businesses to carry out the purposes of the MIP, a county may not be able to meet the prerequisite number of acres it must own in the MIP. This act clarifies that the sale of parcels of land from a MIP for industrial or commercial purposes does not change the original tier status of the MIP or availability of the incentives to successive purchasers based on its original tier status.

The act also temporarily raises the maximum amount of total annual liability for grants for agreements entered into in calendar year 2008 under the Job Development Investment Grant Program from fifteen million dollars ($15,000,000) to twenty-five million dollars ($25,000,000).

SUPPLEMENTAL PEG SUPPORT.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-148	**SB 1716**	**Senator Clodfelter**

AN ACT TO CLARIFY THE DISTRIBUTION OF SUPPLEMENTAL PEG SUPPORT FUNDING AND TO CLARIFY THAT THE SERVICE AREA OF A CITY INCLUDES ANY AREA SUBSEQUENTLY ANNEXED BY THAT CITY.

OVERVIEW: This act does the following:

- It clarifies the distribution of supplemental PEG channel support funding. This part of the act was a recommendation of the Revenue Laws Study Committee, the League of Municipalities, and the Southeast Association of Telecommunications Officers and Advisors.
- It amends the video franchising statutes to clarify that, if the stated boundary of a cable service district is the boundaries of a city, the service area includes any subsequent annexations by the city.

FISCAL IMPACT: This act is expected to have no fiscal impact on General Fund revenues.

EFFECTIVE DATE: This act became effective when the Governor signed it into law on August 2, 2008, and affects distributions made in fiscal year 2008-2009.

ANALYSIS: In 2006, the General Assembly established uniform taxes for video programming services by applying the combined general rate of sales tax to all video programming services and by repealing the authority local governments had to impose a local franchise tax. It preserved the local government revenue stream by distributing part of the sales tax revenues from telecommunications and video programming services to the counties and cities, based on the amount of cable franchise tax imposed during the first six months of fiscal year 2006-2007 plus any subscriber fees imposed during that same period.[201]

Of the revenue distributable to local governments, $2 million a year is allocated for supplemental PEG channel support. A PEG channel is a public, educational, or governmental access channel provided to a county or city. The $2 million allocation is distributed to counties

[201] The purpose of using the 'first six months of fiscal year 2006-2007' was to capture the most recent local franchise tax rates imposed on cable companies and the most recent subscriber fees imposed on consumers of cable service.

and cities with qualifying PEG channels. The annual amount per qualifying PEG channel is $25,000. A county or city may not receive supplemental PEG channel support for more than three PEG channels. The amount distributed to a county or city as supplemental PEG channel support must be used by it for the operation and support of PEG channels. If the total amount distributed for qualifying PEG channels in a fiscal year is less than $2 million, the Secretary must credit the excess amount to the PEG Channel Fund to be used for matching local grants for PEG channel support.

When the General Assembly considered the legislation in 2006, the available data indicated there would be 36 qualifying PEG channels. For the March 2008 distribution, the Department of Revenue received PEG channel certifications for 276 channels. Some of the discrepancy is believed to be due to confusion on the form used by the Department which may have resulted in some channels being double counted or receiving a distribution when they did not qualify.

The act clarifies the distribution requirements, reduces the number of channels receiving the distribution, and provides that all qualifying PEG channels receive supplemental PEG support funding. The act defines in the distribution statute what constitutes a 'qualifying PEG channel' (a channel with character generated programming that does not exceed 15% of eight hours of scheduled programming and is operated for at least 90 days during the year). A county or city must certify all qualifying PEG channels and allocate the proceeds it receives equally among all of its certified PEG channels. A distribution must be made to the PEG channel within 30 days of the county or city's receipt of the supplemental PEG support revenue. This modifies the prior law, in which a county or city could only receive supplemental funding for three PEG channels. These changes address the concerns of some qualifying PEG channels regarding whether supplemental funding is being distributed fairly among the channels by ensuring (i) that each qualifying PEG channel receives supplemental funding, even if a county or city has more than three qualifying channels; (ii) that each qualifying PEG channel receives an equal amount of funding; and (iii) that each qualifying PEG channel receives the funding in a timely manner.

The act also defines a PEG channel operator, requires a county or city to include the name of the PEG channel operator for each qualifying PEG channel it certifies, and requires the county or city to distribute the proceeds to the PEG channel operator. This change better ensures that the money is distributed by the local government for the use of the PEG channels. In addition, where a single PEG channel has more than one operator or the PEG channel is claimed by more than one local government, the change ensures that the funds go to the operator of the PEG channel. It limits a PEG channel operator from being included in multiple certifications for the same PEG channel, which should reduce the number of qualifying PEG channels by eliminating much of the double counting that currently occurs. The act also provides a method to account for revenues that are distributed in error by requiring any county or city that received a distribution in error to submit a revised certification and return all funds received in error. Such funds are added to the amount to be distributed in the following year as supplemental PEG support funding.

Finally, the act allows the Secretary of Revenue to request additional information and extends from July 15, 2008, to September 15, 2008, the period of time a county and city has to make its certification in 2008. The act permits the Department to make the distribution of supplemental PEG channel support for the quarter ending June 30, 2008, based upon the qualifying PEG channel certifications in effect for fiscal year 2007-2008 distributions.

The Senate added a provision to the enacted legislation to address an issue with the video franchising statutes. The act amends the video franchising statutes to clarify that, if the stated boundary of a cable service district is the boundaries of a city, the service area includes any

subsequent annexations by the city. Prior law was interpreted as requiring a new notice of franchise to be filed for the newly annexed area. The act requires a new filing only if the original notice of franchise stated that the boundaries of the service area were the boundaries of the city, as those boundaries existed on a day certain.

SALES TAX REFUND FOR CERTAIN NONPROFITS.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-154	**HB 2509**	**Representative Gibson**

AN ACT TO AUTHORIZE A SEMIANNUAL SALES AND USE TAX REFUND TO A NONPROFIT ORGANIZATION THAT PROCURES, DESIGNS, CONSTRUCTS, OR PROVIDES FACILITIES TO A CONSTITUENT INSTITUTION OF THE UNIVERSITY OF NORTH CAROLINA.

OVERVIEW: This act allows a semi-annual refund of sales and use taxes paid by a nonprofit organization that procures, designs, constructs, or provides facilities to a constituent institution of The University of North Carolina.

FISCAL IMPACT: The act is estimated to reduce General Fund revenues by more than $1.5 million in fiscal year 2008-2009 and by approximately $450,000 in each year thereafter. The act will also reduce local revenues by $810,000 in fiscal year 2008-2009 and by approximately $190,000 each year thereafter. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2008 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The act is effective retroactively to January 1, 2004, and applies to purchases made on or after that date. A refund claim for the period January 1, 2004 through December 31, 2007, will be considered timely filed if it is submitted to the Department of Revenue by October 15, 2008.

ANALYSIS: Direct purchases by a State agency, which by definition includes The University of North Carolina, may be exempt from State and local sales and use tax.[202] A State agency may also receive a quarterly refund of local sales and use taxes paid by it indirectly on building materials, supplies, fixtures, and equipment that become part of a facility owned or leased by the agency.[203] This act provides similar sales and use tax treatment to a nonprofit entity that procures, designs, constructs, or provides facilities to a constituent institution of The University of North Carolina[204] by expanding the list of nonprofit organizations allowed a semi-annual refund of sales and use tax to include this type of nonprofit organization. The act specifically allows the refund to an entity exempt from taxation as a disregarded entity of such a nonprofit organization.

The act provides a refund to a type of nonprofit entity that was denied a sales tax refund from the Department of Revenue in 2004 on the grounds that the nonprofit organization did not qualify as one of the statutorily eligible entities.[205] One such entity, Affinity Housing LLC, filed

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[202] G.S. 105-164.13(52).
[203] G.S. 105-164.14(e).
[204] A constituent institution would include the universities as well as the North Carolina School of the Arts and the North Carolina School of Science and Mathematics. See G.S. 116-4.
[205] See analysis of Section 28.22 of S.L. 2008-107. It specifies the type of nonprofit entities entitled to a sales and use tax refund. The nonprofit entity described in this act does not meet the criteria developed by that act.

a lawsuit against the Department challenging the Department's denial of its refund claim. Affinity Housing LLC is a single-member LLC of Western Carolina University Research and Development Corporation, a section 501(c)(3) nonprofit entity formed to aid and promote the educational and charitable purposes of Western Carolina University. Affinity Housing LLC constructs housing facilities for WCU. The act makes the application of the change retroactive to January 1, 2004, and applicable to purchases made on or after that date. This time period will allow Affinity Housing LLC to receive the refund it originally sought.

Constituent institutions of The University of North Carolina have begun to use nonprofit organizations to procure, design, and construct facilities, such as student housing and dining facilities, on their behalf. An institution leases property to a nonprofit organization and the nonprofit organization constructs the facility on the property. The institution leases the facility from the nonprofit and usually operates and manages the facility. The lease payments made by the institution, recouped through rents charged to students, enable the nonprofit to pay the indebtedness on the facility. At the conclusion of the lease and the retirement of the debt, the ownership of the facility lies with the institution. The General Assembly recognized the trend in 2004 when it expanded the property tax exemption for educational property[206] by exempting property held by a nonprofit entity for the sole benefit of a university located in the State and by expanding the definition of educational purposes to include the operation of a student housing facility or a student dining facility.[207]

The above process has continued to evolve. The institutions have found that privatized facility projects cost less to construct and are completed sooner than traditional facility projects, primarily because the projects are not subject to the State's bidding laws and construction process. At its inception, some of the financing was private financing. Increasingly, the financing is secured through self-liquidating revenue bonds. Today, most of these projects are included in the bond projects submitted to the General Assembly for its approval by The University of North Carolina. The Treasurer's Office exercises oversight of the lease agreements between the institutions and the nonprofit entities.

RESALE OF TICKETS VIA INTERNET.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-158	**SB 1407**	**Senator Hartsell**

AN ACT TO PROTECT CUSTOMERS WHEN PURCHASING TICKETS VIA THE INTERNET AND TO PROHIBIT THE USE OF SOFTWARE TO UNFAIRLY PURCHASE TICKETS OVER THE INTERNET.

OVERVIEW: The act allows the Internet resale of admission tickets in excess of the price printed on the ticket unless the venue where the event occurs prohibits resale, and it prohibits the use of software to unfairly purchase tickets.

FISCAL IMPACT: No fiscal impact estimate is available at this time.

[206] G.S. 105-278.4
[207] S.L. 2004-173

EFFECTIVE DATE: The act became effective when signed into law by the Governor on August 3, 2008, and expires June 30, 2009. Liability and duty to report are not affected by the expiration date of the act.

ANALYSIS: Under current law, it is a Class 2 misdemeanor for a seller or reseller of an admission ticket to charge more than "…the combined face value of the ticket, tax,[208] and the authorized service fee.[209] Because reselling tickets online is a new and growing business, the act provides an exception to the prohibition against admission tickets being resold on the Internet at a price greater than the price printed on the face of the ticket.

The act includes a number of provisions designed to protect the customer and the venue. First, the act makes it an unfair and deceptive trade practice for a person to knowingly sell, give, transfer, use, distribute, or possess software that is primarily designed or produced for the purpose of interfering with the operation of a ticket seller who, pursuant to a written agreement with the venue, sells admission tickets over the Internet. A ticket seller, as well as the venue, has standing to bring a private right of action under the Unfair and Deceptive Trade Practice Act. Under G.S. 75-1.1, each individual violation of the statute constitutes a separate violation. If a person is found to have violated the statute, the aggrieved person is entitled to treble the amount of damages fixed by the verdict. The act requires a person who resells admission tickets to report to the Department of Revenue by the 10th day after the end of each month on the gross receipts received during the previous month from reselling admission tickets for events in the State. The report must include the total amount of gross receipts derived from resell activity (minus the face value on the tickets), the event and venue for which each ticket was sold, the entity from which the reseller purchased each ticket, the amount the reseller paid for each ticket, the price received by the reseller for each ticket, the name and address of reseller-purchasers of each ticket, and any other information required by the Department.

In addition, the act requires a person who resells admission tickets online to provide a ticket guarantee that must be conspicuously displayed on the person's Website and to direct a prospective purchaser to the ticket guarantee before completion of a resale transaction. Additionally, the ticket guarantee must provide a purchaser with a full refund of the amount paid for the ticket if the event is cancelled, the purchaser is denied admission through no fault of the purchaser, or the ticket is not delivered to the purchaser and the failure to receive the ticket results in the purchaser's inability to attend the event. A person may withhold handling and delivery fees from a refunded amount if the Website informs the purchaser of this policy. Finally, a venue may prohibit a person from reselling tickets to an event it sponsors if it files a notice of prohibition with the Secretary of State and posts the notice on its Website and on the Website of the primary ticket seller. A prohibition may not become valid until 30 days after the notice is posted on the Website. The prohibition expires on December 31 of each year unless the venue renews its prohibition.

The bill, as originally introduced in the Senate, provided for the imposition of a 3% gross receipts privilege tax on the difference between the price of the ticket sold and the face price on the ticket.[210] This provision was deleted from the bill when the bill was in the House Finance Committee. The sunset date will necessitate the General Assembly revisiting this issue during the 2009 Session.

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[208] The tax on the sale of admission prices for entertainment events is a gross receipts tax of 3%. See G.S. 105-37.1.

[209] The service fee is limited to no more than $3.00 unless the promoter of the event and the ticket sales agency, in writing, agree to and make known to the public a different amount.

[210] The gross receipts tax is currently imposed on the face price of the ticket when it is originally sold.

FUTURE CONVEYANCES/SPECIAL ASSESSMENTS.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-165, as amended by S.L. 2008-187	**HB 1770**	**Representative McComas**

AN ACT TO CLARIFY THE AUTHORITY OF THE PARTIES TO CONSERVATION AND PRESERVATION AGREEMENTS TO INCLUDE PROVISIONS IN THE AGREEMENTS FOR THE PAYMENT OF FEES UPON FUTURE CONVEYANCE OF PROPERTY SUBJECT TO THE AGREEMENTS AND TO ALLOW SPECIAL ASSESSMENTS TO BE PAID IN MORE THAN TEN ANNUAL INSTALLMENTS AND TO BE PLEDGED TO THE REPAYMENT OF REVENUE BONDS ISSUED FOR CRITICAL INFRASTRUCTURE NEEDS.

OVERVIEW: Sections 2 and 3 of this act give counties and cities an opportunity to finance long-term capital projects related to water and sewer infrastructure, stormwater infrastructure, public transportation, schools, and roads through the issuance of revenue bonds that will be paid by levying special assessments on the affected properties. The remainder of this act does not affect North Carolina tax laws and is not discussed below.

FISCAL IMPACT: There is no impact on General Fund revenues.

EFFECTIVE DATE: These sections became effective when signed into law by the Governor on August 3, 2008, and expire on July 1, 2013. The expiration does not affect the validity of assessments imposed or bonds issued or authorized under the provisions of this act prior to the effective date of the expiration.

ANALYSIS: Sections 2 and 3 of this act give counties and cities an opportunity to use assessments as a financing tool for long-term capital projects related to water and sewer infrastructure, stormwater infrastructure, public transportation, schools, and roads. The act accomplishes this goal by enacting new articles within Chapter 153A and Chapter 160A supplementing the current authority counties and cities have to levy assessments and issue revenue bonds.[211] Counties and cities will be able to pay for a project for which an assessment is imposed solely with revenue bonds to be paid from the assessments or from a combination of financing sources that include revenue bonds, general obligation bonds, and general revenue. This change will particularly aid counties and cities that face increased demands for infrastructure improvements as a result of rapid growth and development. The act gives counties and the cities located within the counties the authority to impose assessments for the following projects:

- Providing sanitary sewer systems, including community sewerage facilities for the collection, treatment, and disposal of sewage or septic tank systems and other on-site collection and disposal facilities or systems.
- Providing storm sewers and flood control facilities, including levees, dikes, diversionary channels, drains, catch basins, and other facilities for storm water drainage.
- Providing water systems, including facilities for the supply, storage, treatment, and distribution of water.

[211] See Article 9A of Chapter 153A (Counties) and Article 10A of Chapter 160A (Cities and Towns) of the act.

- Providing public transportation facilities, including equipment for public transportation, buses, surface and below ground railways, ferries, and garage facilities.
- Providing school facilities, including schoolhouses, buildings, plants and other facilities, physical and vocational educational buildings and facilities, including in connection therewith classrooms, laboratories, libraries, auditoriums, administrative offices, gymnasiums, athletic fields, lunchrooms, utility plants, garages, and school buses and other necessary vehicles.
- Providing streets and sidewalks, including bridges, viaducts, causeways, overpasses, underpasses, and alleys; paving, grading, resurfacing, and widening streets; sidewalks, curbs and gutters, culverts, and drains; traffic controls, signals, and markers; lighting; and grade crossing and the elimination thereof and grade separations.

The governing body of a county or city may not impose assessments under the new articles unless it receives a petition for the project to be financed through assessments signed by at least a majority of the owners of the property assessed. The county board of commissioners or city council must establish an assessment method that will most accurately assess property according to the benefits conferred upon it by the project for which the assessment is made. In establishing the assessment method, the county board of commissioners or city council must first determine the project's total estimated cost, and a preliminary assessment roll may then be prepared before the costs of the project are incurred based on the estimated cost of the project.[212] Unlike assessments currently imposed under Article 9 of Chapter 153A and Article 10 of Chapter 160A, the cost of assessments imposed for these infrastructure projects may include any expenses allowed under the State and Local Government Revenue Bond Act. The primary expense allowed under the Revenue Bond Act that is not considered under Article 9 and Article 10 is interest on the bonds or notes issued in anticipation of the revenue bond issuance during construction and an establishment of debt service reserves. Also, unlike assessments the county or city may currently impose, assessments issued for long-term infrastructure projects under the act must be paid in annual installments over a period not to exceed 30 years.[213] These annual payments are due on the date property taxes are due.

In addition to other financing tools available for infrastructure projects, the act provides that an infrastructure project for which an assessment may be imposed under the new articles may be considered a revenue bond project for purposes of the State and Local Government Revenue Bond Act, and that the assessments imposed under the new articles may be considered revenues for purposes of the Act. All of the provisions governing revenue bonds in Article 5 of Chapter 159 apply to the new articles. To issue revenue bonds, a county or city must first apply to the Local Government Commission (LGC) for approval of the revenue bond issue. The State and Local Government Revenue Bond Act sets forth the matters the LGC must consider before giving a county or city approval to issue revenue bonds. It must determine that the proposed revenue bond issue is necessary, that the amount proposed is adequate and not excessive, that the proposed project is feasible, that the county's or city's debt management procedures and policies are good, and that the proposed revenue bonds can be marketed at reasonable interest costs.

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[212] Sections 47.5.(a) and (b) of S.L. 2008-187, the 2008 technical corrections bill, clarify that a preliminary assessment roll may be prepared based on the estimated cost of the project, corrects a statutory reference, and adds a phrase that was inadvertently omitted.

[213] Assessments under Articles 9 and 10 must be paid in full unless the county or city provides that they may be paid in annual installments, which may not be more than 10 years.

Except as otherwise provided under these new articles, the provisions for imposing special assessments under Article 9 of Chapter 153A and Article 10 of Chapter 160A apply to the special assessments imposed under these new articles. Under Article 9 and Article 10, when a county or city decides to finance all or part of a project by special assessments, it must first adopt a preliminary assessment resolution that describes the project, the proposed basis for making the assessment, and information concerning the cost of the work and the terms of payment of the assessment. If the basis for making the assessment is either the area of land benefited by the project or the valuation of the land benefited by the project, then the resolution must contain a description of the boundaries of the area benefited. The county or city must hold a public hearing on the matter, prepare a preliminary assessment roll, and publish a confirmation of the assessment roll once it is adopted. An owner of property against which an assessment is made may file a notice of appeal to the General Court of Justice if the owner is dissatisfied with the amount of the assessment. Unpaid assessments bear interest at a rate fixed in the assessment resolution. A county or city may foreclose assessment liens under procedures provided by law for the foreclosure of property tax liens.

WILDLIFE LAND PROPERTY TAX CHANGES.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-171	**HB 1889**	**Rep. Harrison, Gibson, Hill, Brubaker**

AN ACT TO PROVIDE PROPERTY TAX RELIEF FOR QUALIFYING WILDLIFE CONSERVATION LAND, TO CLARIFY THE PRESENT-USE VALUATION OF PROPERTY SUBJECT TO A CONSERVATION EASEMENT, AND TO PROVIDE A PROPERTY TAX EXEMPTION FOR LEASEHOLD INTEREST IN CERTAIN EXEMPTED PROPERTY.

OVERVIEW: This act does three things:

- It designates wildlife conservation land as a special class of property for property tax purposes and provides that it may be appraised and taxed as if it were classified as agricultural land under the present-use value system. This part of the act becomes effective for taxes imposed for taxable years beginning on or after July 1, 2010.
- It provides that property appraised at its present-use value will continue to qualify for present-use value when the owner donates the property for conservation purposes so long as the property is subject to a conservation easement that qualifies for the conservation income tax credit for donated lands and the owner received no more than 75% of the fair market value of the donated property as compensation. This part of the act becomes effective for taxes imposed for taxable years beginning on or after July 1, 2010.
- It exempts from property tax a leasehold interest in property if the property itself is exempt from property tax because it is owned by a unit of government and the property is used to provide affordable housing for employees of the unit of government that owns the property. This part of the act became effective for taxes imposed for taxable years beginning on or after July 1, 2008.

FISCAL IMPACT: The fiscal impact of this act will affect local government revenues. The North Carolina Wildlife Commission has indicated that no reliable data is available regarding

the number of acres that may qualify for the wildlife conservation classification; therefore, no estimate is available for this part of the act. The difference in the assessed value of property subject to a conservation easement and property in the present-use value program do not significantly differ; therefore this part of the act is expected to have minimal impact. Lastly, the act provides a property tax exemption for certain leasehold interests in exempt property. At the present time, Dare County is the only county that has property that will be impacted by this change and the impact is expected to be minimal.

EFFECTIVE DATE: See the **OVERVIEW**.

ANALYSIS: The act establishes a new property tax classification for property used for wildlife conservation and values that property at its value as agricultural land rather than its fair market value. It clarifies the present-use valuation of property subject to a conservation easement, and it exempts from property tax a leasehold interest in certain property used to provide affordable housing.

Wildlife Conservation Land. – Since 1973, the General Assembly has provided special property tax treatment for farmland that is classified and used for agricultural, horticultural, or forest purposes. If the farmland meets certain ownership and size requirements and is engaged in commercial production under a sound management program, the land may be appraised and taxed at its present-use value (PUV) as opposed to its fair market value. Agricultural land and horticultural land must also meet an income requirement: the land must have one tract that produced at least $1,000 average gross income over the three preceding years. The difference between the taxes due on the PUV and the taxes that would have been payable in the absence of the special tax treatment are known as deferred taxes. When the land becomes disqualified for PUV, the land is taxed at its fair market value for the year in which it loses its classification and the deferred taxes for the three previous years become due and payable, with interest.

During the 2007 session, the General Assembly extended PUV treatment and classification to land used as an aquatic species farm[214] and to working waterfront property.[215] This act extends PUV treatment to property used for wildlife conservation. To be eligible for this classification, the property must meet the following size, ownership, and use requirements:

- **Size.** – The land must consist of at least 20 contiguous acres. An owner may not classify more than 100 acres of land as wildlife conservation land within a county.
- **Ownership.** – The land must be owned by an individual, a family business entity[216] or a family trust[217] and it must have been owned by the same owner for the previous five years. Land owned by a business entity[218] is not eligible for PUV classification if the business entity is a corporation whose shares are publicly traded or one of its members

[214] Part III, S.L. 2007-497.
[215] Part I, S.L. 2007-485.
[216] A family business entity is defined as a business entity whose members are, directly or indirectly, individuals and relatives. An individual is indirectly a member of a business entity if the individual is a member of a business entity or a beneficiary of a trust that is part of the ownership structure of a business entity.
[217] A family trust is defined as a trust that was created by an individual and whose beneficiaries are, directly or indirectly, individuals who are the creator of the trust or a relative of the creator. An individual is indirectly a beneficiary of a trust if the individual is a beneficiary of another trust or a member of a business entity that has a beneficial interest in the trust.
[218] A business entity is defined as a corporation, a general partnership, a limited partnership, or a limited liability company.

is a corporation whose shares are publicly traded. The act provides these exceptions to the ownership requirements:

- The 5-year time period is considered met if the land has been owned by a member of the family business for five years or if owned by a beneficiary of the family trust for five years.[219]
- The 5-year time period is waived if the property acquired was classified as wildlife conservation land in the hands of the previous owner and the current owner continues to use the land as wildlife conservation land. To classify property under this exception, the new owner must file an application for PUV and must sign the wildlife habitat conservation agreement in effect for the property within 60 days after acquiring it.

- **Use.** – The land must meet both of the following use requirements:
  - The land is managed under a wildlife habitat conservation agreement[220] with the North Carolina Wildlife Resources Commission and the agreement is in effect as of January 1 of the year for which the benefit is claimed. The agreement must require the owner to manage the land to protect an animal species that lives on the land and is on a North Carolina protected animal list published by the Commission[221] or to conserve one of the following priority animal wildlife habitats: longleaf pine forest, early successional habitat, small wetland community, stream and riparian zone, rock outcrop, or bat cave.
  - The land must have been classified as either agricultural, horticultural, or forest land under the PUV classification when the wildlife conservation agreement was signed. This requirement may be waived if the owner can demonstrate to both the Wildlife Resources Commission and the county tax assessor that the owner used the land for a purpose specified in the signed wildlife conservation agreement for three years preceding the year for which the benefit of this special tax treatment is desired.

Property classified as wildlife conservation property under the PUV system loses its eligibility for the special tax treatment whenever it fails to meet one or more of the size, ownership, and use requirements. The owner of property classified as wildlife conservation property must notify

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[219] These are the PUV ownership changes enacted in S.L. 2008-146. The members of a business entity would no longer be restricted to individuals but would include trusts and other business entities as long as a member was not a corporation whose shares are publicly traded and none of its members are corporations whose shares are publicly traded.

[220] The North Carolina Wildlife Resources Commission does not currently have a wildlife habitat conservation agreement. It will develop this agreement.

[221] The North Carolina Wildlife Action Plan, developed in compliance with a Congressional mandate, was submitted in 2005 to provide a conservation blueprint to advance the sound management of fish and wildlife resources in the future. The Plan identifies fish and wildlife resources and priority conservation needs associated with those resources. There are currently about 12 identified priority wildlife habitats in the State. There are a number of federally-listed threatened or endangered animal species and State listed animal species. There are also State and federal natural resource management plans for which wildlife habitat is its primary objective, such as Forest Stewardship, Cooperative Upland Habitat Restoration and Enhancement Program (CURE), and Wildlife Habitat Incentives Program. Link to North Carolina State and Federally listed wildlife species: www.ncwildlife.org/fs_index_07_conservation.htm

the county assessor whenever there is a change in the size, ownership, or use of the property that necessitates a review of the exclusion. An owner who fails to do so is subject to a penalty equal to 10% of the amount of the deferred taxes and interest for each listing period that the owner fails to report.[222]

As with other property in the PUV classification, property that loses its eligibility for the classification will be taxed at its fair market value for the year in which it loses its eligibility and the deferred taxes for the three previous years will become due and payable, with interest. The act provides several exceptions to this rule:

- No deferred taxes are due, and the lien for deferred taxes is extinguished, when the owner conveys the property by gift to a nonprofit organization for educational and scientific purposes as a protected natural area or for nonprofit historic preservation purposes; or to the State, a political subdivision of the State, or the United States.
- No deferred taxes are due, but the deferred taxes remain a lien on the property, when the property reverts back to its original farmland use under the PUV program. This exception requires that the property was previously classified under the PUV program and that the ownership of the property does not change. Similarly, no deferred taxes are due on property originally classified as farmland if the property is reclassified as wildlife conservation land.[223]
- No deferred taxes are due, but the deferred taxes remain a lien on the property, when the property is transferred to an owner who signs the wildlife habitat conservation agreement in effect for the land at the time of the transfer and the land remains classified as wildlife conservation property.[224]

The issue of classifying wildlife conservation property as a special class of property whose value may be partially excluded from taxation has been discussed for several years. This part of the act represents the collaborative work of representatives from the North Carolina Association of County Commissioners, various conservation groups, county tax assessors, the Forestry Association, the Wildlife Resources Commission, and the North Carolina Farm Bureau. The act directs the Revenue Laws Study Committee to study the three-year impact of the wildlife conservation land classification and its fiscal impact on local governments. The Committee is to report its findings to the 2015 General Assembly.

Land Subject to a Conservation Eeasement. – North Carolina provides an income tax credit to individual and corporate taxpayers who donate an interest in real property for conservation purposes to the State, a local government, or a body that is organized to receive and administer lands for conservation purposes and qualified to receive charitable contributions.[225] The

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[222]G.S. 105-282.1 requires an owner of any property eligible to be exempted or excluded from property tax to notify the county tax assessor of any change in the property's value or property's eligibility for the exemption or exclusion.

[223] See Section 5 of the act.

[224] This exception to the payment of the deferred taxes coincides with the waiver of the 5-year ownership requirement when the property acquired was classified as wildlife conservation land in the hands of the previous owner and the current owner continues to use the land as wildlife conservation land.

[225] The property interest must be donated in perpetuity and be useful for public beach access or use, public access to public waters or trails, fish and wildlife conservation, forestland or farmland conservation, watershed protection, conservation of natural areas, conservation of natural or scenic rivers areas, conservation of predominantly natural parkland, or historic landscape conservation.

property tax value determination of property subject to a conservation easement must take into consideration the advantages and disadvantages of the conditions of the easement on the market value of the property. In some instances, the value of property subject to an easement is greater than the value that property would be if it was classified as farmland under the PUV program.

Prior to 2002, property classified within the PUV program that became subject to a conservation easement lost its PUV assessment because the property could no longer meet the use and income-producing requirements for PUV classification. Whenever property becomes ineligible for the program, the current year's taxes, as well as the three years of deferred taxes, become due and payable. In 2002, the General Assembly created an exception to the use and income-producing requirements for PUV by allowing property subject to a conservation easement to remain in the PUV program.

The Property Tax Division within the Department of Revenue interprets this exception to the PUV program narrowly to allow property to remain in the program only when the entire conservation easement is donated. In contrast, the Income Tax Division within the Department has allowed an income tax credit for any percentage of the easement value that is donated. For example, if a taxpayer donates an easement for conservation purposes to the State valued at $100,000 and receives $60,000 for the easement, the taxpayer has donated an easement worth $40,000. The taxpayer is then allowed an income tax credit equal to 25% of the donated value, or $10,000. However, because the taxpayer received some compensation for the easement, the property becomes ineligible for special property tax treatment under the PUV program. This act specifies that property may remain in the PUV program as long as it is subject to an enforceable conservation easement and the taxpayer received no more than 75% of the fair market value of the donated property interest in compensation. This part of the act becomes effective for taxable years beginning on or after July 1, 2010.

Property Tax Exemption of Certain Leasehold Interests. – This act exempts from property tax a leasehold interest in exempt property, effective for taxes imposed for taxable years beginning on or after July 1, 2008, if the following two conditions are met:

- The property itself is exempt from property tax because it is owned by a unit of government.
- The property is used to provide affordable housing for employees of the unit of government that owns the property.

An example of this property tax exemption is the leasehold interest of the Dare Education Foundation in property that is exempt in the hands of its owner, the Dare County Board of Education and used to provide affordable housing for teachers. An application for this exemption is timely if filed on or before September 1, 2008. Prior to this change, a leasehold interest in exempted property was subject to property tax.

UNC NONAPP. CAP. PROJECTS/AIRPORT AUTHORITY.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-204	**SB 1925**	**Senator Kerr**

AN ACT TO AUTHORIZE THE CONSTRUCTION AND THE FINANCING, WITHOUT APPROPRIATIONS FROM THE GENERAL FUND, OF CERTAIN CAPITAL IMPROVEMENTS

PROJECTS OF THE CONSTITUENT INSTITUTIONS OF THE UNIVERSITY OF NORTH CAROLINA; TO REVISE UNIVERSITY GENERAL OBLIGATION INDEBTEDNESS; TO ALLOW THE UNIVERSITY OF NORTH CAROLINA TO CREATE AIRPORT AUTHORITIES TO SUPPORT THE MISSION OF THE UNIVERSITY, ITS CONSTITUENT INSTITUTIONS, OR THE UNIVERSITY OF NORTH CAROLINA HEALTH CARE SYSTEM; TO AUTHORIZE THE STATE EDUCATION ASSISTANCE AUTHORITY TO SET THE INTEREST RATE FOR THREE SCHOLARSHIP LOAN PROGRAMS AT A RATE NOT TO EXCEED TEN PERCENT PER ANNUM; AND TO MODIFY THE RESPONSIBILITIES OF THE NORTH CAROLINA FEDERAL TAX REFORM ALLOCATION COMMITTEE.

OVERVIEW: This act does the following:

- Authorizes the construction of numerous projects by The University of North Carolina using revenue bonds and special obligation bonds.
- Revises a UNC Bond Project from the 2000 Higher Education Bond Program by reducing a portion of the 2000 general obligation bond issuance for 'Berryhill Laboratory Building' at UNC-Chapel Hill by $8.6 million and using the money to fund a new project, 'Division of Laboratory Animal Medicine – Upfits'.
- Exempts the purchase, construction, and operation of capital facilities by Gateway University Research Park, Inc., a joint Millennial Campus in Greensboro, from the procurement provisions required for capital facilities financed through the State Capital Facilities Financing Act, except for the procurement provisions in Article 8 (Public Contracts) of the Act.
- Authorizes the Board of Governors to create one airport authority in Orange County for the sole purpose of resiting and operating the Horace Williams Airport. The authorized airport authority must support the mission of the University of North Carolina at Chapel Hill or the University of North Carolina Health Care System.
- Authorizes the State Education Assistance Authority to set the interest rate for three scholarship programs in an amount not to exceed 10% a year instead of the current fixed rate of 10%.
- Allows North Carolina to issue tax-exempt qualified educational facility bonds, the proceeds of which are used by a private for-profit corporation that has entered into a public-private partnership agreement with a local school administrative unit to construct, rehabilitate, refurbish, or equip an elementary or secondary public school.

FISCAL IMPACT: There is no impact on General Fund revenues. The self-liquidating projects are financed with funds available to the institutions from gifts, grants, receipts, self-liquidating indebtedness, or other funds or a combination of these funds, but not including funds received for tuition or appropriated from the General Fund.*(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2008 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: Except at otherwise specified, this act became effective when signed into law by the Governor on August 8, 2008.

ANALYSIS:

Part I: Self-Liquidating Projects

Each year the University of North Carolina requests legislative authorization for needed capital projects at its constituent or affiliated institutions. These projects are funded by two types of

self-liquidating bonds that may be issued by the University's Board of Governors.[226] Section 1.2 of the act authorizes 31 projects on nine campuses.[227] The Chancellors and Boards of Trustees for the listed campuses, as well as the President and the Board of Governors have approved these projects. Construction of these projects is expected to begin before June 30, 2009. The maximum principal amount of bonds to be issued for the projects will not exceed the specified costs of the projects plus $25 million for related additional costs for which bond proceeds are routinely used, such as issuance expenses, funding of reserve funds, and capitalized interest. Section 1.3 of the act authorizes planning money for five projects on three campuses. Sections 1.6 and 1.9 of the act exempt the following projects from the statutory requirement regarding location of special obligation projects: UNC-Chapel Hill's Research Resource Facility – Phase III capital project, UNC-Chapel Hill's Cogeneration and Steam Infrastructure Improvement and Expansion capital project, ECU's Athletic Facilities Expansion and Improvement capital project, and NCSU's Avent Ferry Administration Center Renovation capital project. Sections 1.7 and 1.8 of the act authorize UNC-Chapel Hill and Appalachian State University to construct and finance the expansion and renovation of their football stadiums through lease arrangements to and from a third party. Once constructed and approved by the State reviewing agencies, these improvements would transfer to the State. Section 1.7 of the act also provides that after the property is transferred to the State, UNC-Chapel Hill may provide for the operation and maintenance of the facilty through a contractual or lease agreement with a third party.

Part II: Revise University General Obligation Indebtedness

This part of the act modifies a UNC bond project authorized in the 2000 Higher Education Bond Program by transferring up to $8.6 million of the 2000 bond funding for the Berryhill Hall Laboratory Building to a related project called 'Division of Laboratory Animal Medicine – Upfits'. Berryhill Hall is the primary education building for the UNC School of Medicine. The Hall is not large enough to support the planned enrollment expansion in the medical program. UNC-Chapel Hill will recommend replacement of Berryhill Hall and seek needed funding in the future. The new project, Division of Laboratory Animal Medicine – Upfits, will use the balance of the Berryhill Hall renovation funds to renovate other related teaching and research support space in existing campus facilities. These renovated facilities will provide the necessary space for those displaced during the construction of the new medical education building and future projects.

Part III: Procurement Modifications

This part of the act removes the purchase, construction, and operation of capital facilities by Gateway University Research Park, Inc. (hereinafter Gateway) from all procurement provisions required for capital facilities financed through the State Capital Facilities Financing Act, except

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[226] Article 21 of Chapter 116 of the General Statutes authorizes the Board to issue revenue bonds for educational buildings, dormitories, recreational facilities, dining facilities, student centers, health care buildings, parking decks, etc. These revenue bonds are payable from rentals, charges, fees, and other revenues generated by the facility but not from tax revenues. Article 3 of Chapter 116D of the General Statutes authorizes the Board to issue special obligation bonds payable with any sources of income or receipts of the Board or a constituent or affiliated institution, but not including tuition payments or appropriations from the General Fund. These bond proceeds can be used for construction, improvement, and acquisition of any capital facilities located at UNC constituent and affiliated institutions.

[227] These projects include academic, research, clinical and administrative space and improvements to student services, residential living, dining, recreation, and athletic facilities.

for those provisions in Article 8 of the Act.[228] Article 8 requires separate contract specifications, adherence to minority business participation goals, and bidding requirements. Gateway is a 501(c)(3) organization controlled by North Carolina A & T and UNC-G to manage construction projects at the Gateway University Research Park, a joint millennial campus created by the Board of Governors. This statutory change codifies Gateway's authority to manage construction projects in accordance with Gateway's Management Services and Development Agreement with North Carolina A & T and UNC-G and its Ground Lease Agreement with the State approved by the Council of State in 2007. The change to G.S. 142-94 allows Gateway to continue to follow its streamlined bidding and procurement process for construction of all facilities located on the Joint Millennial Campus. This process is explicitly described and included in the Ground Lease Agreement, which also incorporates substantial oversight protections. Currently, this statutory change affects two projects.

Part IV: Allow the University of North Carolina to Create an Airport Authority

This part of the act establishes a new article in Chapter 116 of the General Statutes authorizing the Board of Governors to create one airport authority in Orange County for the sole purpose of resiting and operating the Horace Williams Airport.[229] The airport authority must support the mission of UNC-Chapel Hill or the UNC Health Care System. Horace Williams Airport is a university-owned airport that opened in 1940. The Airport is the hub for planes serving the North Carolina Area Health Education Centers (AHEC) Program based in the UNC School of Medicine. AHEC transports UNC medical faculty across the State to provide specialty clinics and educational programs in underserved areas. The Airport also houses private planes. As early as 2002, the University announced plans to close the Airport and use the site for a planned satellite research campus, Carolina North. After much debate among the University, the Town of Chapel Hill, supporters of AHEC, and private pilots, the General Assembly authorized the Board of Governors to create the airport authority.

An airport authority authorized by the Article must consist of 15 appointed members and may be created to support the mission of UNC-Chapel Hill, one constituent institution and the UNC Health Care System, or the UNC Health Care system. In August, the Board of Governors decided to create an airport authority to support the mission of the constituent institution, UNC-Chapel Hill, and the University of North Carolina Health Care System. Pursuant to the Article, the 15 appointed members must consist of the following: one member appointed by the General Assembly upon the recommendation of the Speaker of the House, one member appointed by the General Assembly upon the recommendation of the President Pro Tempore of the Senate, eight members appointed by the Board of Governors (four members upon the recommendation of the UNC-Chapel Hill Board of Trustees and four members by the UNC Health Care System), three members appointed by the Orange County Board of Commissioners, and one member appointed by the Chapel Hill Town Council. No member of the General Assembly may serve on an airport authority created under the Article.

The general powers of an airport authority created under the Article include the following: powers that a city or county has over airports; powers regarding financing capital expenditures and operations that are delegated to or conferred upon constituent institutions or the UNC Health Care System; to sue and be sued; to establish, operate, and maintain an airport; to expend funds for these purposes; to lease property; to receive a sales tax refund; to borrow money; and to acquire property by eminent domain, except over property held on July 1,

[228] G.S. 142-94 of Article 9, Chapter 142.
[229] Article 13 of Chapter 116 (Higher Education) of the General Statutes.

2008 by a 501(c)(3) organization organized for educational purposes. If regulations adopted by the airport authority and development regulations adopted by Orange County or a municipality in the County apply to land owned by and the approaches to land owned by the airport authority, then the more restrictive regulations apply.

If the airport authority created under the Article ceases its operation, then the title to the authority's property shall vest in The University of North Carolina. The proceeds of the sale of the property must first be distributed pro rata to the constituent university member or to the UNC Health Care System for reimbursement purposes.

Part V: Interest Rate for Scholarship Loan Programs[230]

This part of the act authorizes the State Education Assistance Authority (SEAA) to set the interest rate for the following three scholarship programs at a rate not to exceed 10%: the Nursing Scholars Program, the Graduate Nurse Scholarship Program for Faculty Production, and Principal Fellows Program. A loan under each of these scholarship programs is a free grant if the student fulfills the service commitment, and the intent of the loan is for the recipient to serve the State as opposed to repaying in cash. This part of the act becomes effective January 1, 2009, and applies to loans issued on or after July 1, 2009.

The responsibility for establishing the interest rate for the State scholarship loan programs differs according to the program. In some cases, the SEAA has the responsibility to set the rate, in others, such as these three programs, the interest rate is set by statute at 10%. According to the SEAA, the statutorily set 10% rate has been a promotional obstacle for these scholarship programs because it is significantly higher than federal loan rates, such as the Stafford Loan, which has a rate of 6.8%. The SEAA requested this change to encourage students to apply for the programs. Below are descriptions of the three programs:

- **Nursing Scholars Program** - This program offers scholarship loans of up to $6,500 per year with a maximum of four years per recipient to North Carolina residents interested in preparing to become registered nurses through an associate or baccalaureate degree program. If also offers up to $6,500 per year per recipient for two years of study leading to a master of science in nursing. The loan is forgiven if, within seven years after graduation, the recipient practices nursing in North Carolina for one year for each year of aid received. While the statutory maximum was increased to $6,500 in 2006, the current award amounts actually offered are $3,000 per year for applicants pursuing an associates degree or hospital diploma in nursing and $5,000 per year for applicants pursing a bachelor of science degree in nursing.
- **Graduate Nurse Scholarship Program for Faculty Production** – This program offers scholarship loans in the amount of $15,000 per year per recipient for the following: (1) students enrolled in a masters program in nursing education; (2) students enrolled in a doctoral degree program in nursing education; and (3) nursing faculty in the North Carolina Community College System enrolled in a masters degree program in nursing education. The loan is forgiven if, within seven years after graduation, the recipient teaches in a public or private nursing education program in a public or private educational institution in North Carolina for one year for every year of aid received. If the recipient was a nursing faculty member of a community college, the loan will be

[230] Part V of the act was initially introduced in Senate Bill 1070, which passed the Senate. The substance of SB 1070 was put in Part V of the act, because it did not appear that the bill was eligible for consideration during the Short Session.

forgiven if the recipient teaches in a community college nursing education program in North Carolina one year for each year of aid received.

- **Principal Fellow Program** – This program requires, within six years after graduation, a four-year commitment to serve as a school administrator in a North Carolina public school to receive the $30,000 first-year stipend and the second-year loan in the amount of 60% of the beginning salary for an assistant principal plus $4,100 for tuition, fees, and books.[231]

Part VI: Modify TRAC Responsibilities[232]

This part of the act enables North Carolina to issue tax-exempt qualified educational facility bonds, the proceeds of which may be used by a private for-profit corporation that has entered into a public-private partnership agreement with a local school administrative unit to construct, rehabilitate, refurbish, or equip an elementary or secondary public school.

Qualified private activity bonds are tax-exempt bonds[233] issued by a state or local government, the proceeds of which are used for a defined qualified purpose by an entity other than the government issuing the bonds. A qualified private activity bond is secured by the financed project's revenues rather than the full faith and credit of the governmental unit. Qualified private activity bonds enable the private sector to access tax-exempt capital markets, thereby reducing a project's financing costs. Federal law limits the aggregate amount of private activity bonds that may be issued by a state.

In the Economic Growth and Reconciliation Act of 2001, Congress expanded the purpose for which qualified private activity bonds could be issued to include qualified public educational facilities. A qualified educational facility is a public elementary or secondary school owned by a private, for-profit corporation pursuant to a public-private partnership agreement with a State or local educational agency. The expansion of a qualified purpose to include educational facilities allows more tax-exempt financing of public school construction. In 2006, the General Assembly enacted legislation to facilitate the building of public school facilities through public-private partnerships.[234] The authorization allowing local school administrative units to use capital lease financing expires July 1, 2011. To date, no school facilities have been financed through this authority.

North Carolina cannot currently avail itself of the use of qualified educational facility bonds because the statutes do not authorize their allocation or issuance. The General Assembly created the North Carolina Federal Tax Reform Allocation Committee in 1987 to manage the allocation of tax exempt private activity bonds and low-income housing credits. This act expands the authority of the Committee to include the allocation and issuance of qualified public educational facility bonds. This legislation, together with the legislation enacted in 2006[235], provides another financing alternative for public school construction.

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[231] These amounts may be adjusted to take into account increases in tuition, fees, and the cost of books; increases in the State principal assistant salary schedule; and changes in the stipend paid to participants in the program during the second-year internship.

[232] Part VI of the act was initially introduced in Senate Bill 1902, which passed the Senate, and House Bill 2724. The substance of these bills was put in Part VI of the act, because it did not appear that these bills were eligible for consideration during the Short Session.

[233] The interest paid to the bondholder is not includable in their taxable income.

[234] S.L. 2006-232, as amended by S.L. 2006-259.

[235] S.L. 2006 232, as amended by S.L. 2006 259.

Federal law limits an issuing authority to a maximum amount of tax-exempt bonds that may be issued to finance a qualified educational facility to the greater of $5 million or $10 multiplied by a state's population. Based upon North Carolina's population, its 2008 allocation is $90.6 million and its 2007 allocation was $88 million. A state may elect to carry forward the unused bond volume cap for any calendar year for three years following the calendar year in which the unused volume cap arose. This election is made by filing IRS Form 8328. The Treasurer's Office filed a carryforward for 2007. On the effective date of the act, North Carolina had two years of allocation, or approximately $178 million, to allocate for qualified educational facility bonds.

HOME INSPECTOR PRIVILEGE LICENSE.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-206	**HB 2558**	**Representative Ross**

AN ACT TO REQUIRE LICENSED HOME INSPECTORS TO OBTAIN A PRIVILEGE LICENSE.

OVERVIEW: This act imposes a $50 State privilege license tax on individuals licensed under the Home Inspector Licensure Act.

FISCAL IMPACT: The act increases General Fund revenues by $77,000.

EFFECTIVE DATE: This act became effective when signed into law by the Governor, August 9, 2008, and applies to taxable years beginning on or after July 1, 2008.

ANALYSIS: This act imposes an annual State privilege license tax of $50 on an individual licensed under the Home Inspector Licensure Act.[236] The State's privilege license tax is imposed on a fiscal year basis and is due by July 1 of each year. The full amount of the tax applies to a person who, during the fiscal year, begins to engage in an activity for which a privilege license is required. Since the act became effective after July 1, 2008, it includes a provision extending the time in which a person engaged in the business of home inspection has to obtain the required State license for fiscal year 2008-2009, from July 1, 2008, until October 1, 2008.

By imposing a State license tax on this profession, the act repeals the authority of cities to impose a local license tax on this profession.[237] Under the general authority of G.S. 160A-211, several cities impose a privilege license tax on home inspectors. Since many of these cities have already collected the tax for fiscal year 2008-2009, the act specifically authorizes its imposition and collection by those cities for this fiscal year. A city cannot impose a license tax on this profession for fiscal years beginning on or after July 1, 2009.

An individual required to have a State privilege license may not engage in the licensed activity until a license is obtained. To obtain a license, an individual must file a completed application with the Department of Revenue and pay the required tax. An application for a license is considered a return. The license does not of itself authorize the practice of a profession, business, or trade for which a State qualification license is required.

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[236] Article 9F of Chapter 143 requires home inspectors and associate home inspectors to be licensed. The state privilege license tax imposed under this act applies to both types of licenses.
[237] G.S. 105-42(h).

SOLID WASTE TAX CHANGES/UNSALABLE OTP REFUND.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-207	**HB 2530**	**Rep. Harrison, T. Harrell, Luebke, Thomas**

AN ACT TO MAKE ADMINISTRATIVE CHANGES TO THE SOLID WASTE DISPOSAL TAX AND TO ALLOW A REFUND FOR ALL UNSALABLE OTHER TOBACCO PRODUCTS.

OVERVIEW: This act does two things:

- It makes changes the Solid Waste Disposal Tax that became effective July 1, 2008.
- It allows a refund of the tax paid on unsalable tobacco products other than cigarettes (OTP).

FISCAL IMPACT: This act is expected to reduce General Fund Revenues by approximately $9,000 annually.

EFFECTIVE DATE: The provisions allowing a refund of the tax paid on unsalable OTP became effective October 1, 2008, and apply to products returned on or after that date. The remainder of the act became effective when signed into law by the Governor on August 9, 2008.

ANALYSIS: The act makes certain administrative changes to the solid waste disposal tax. First, it clarifies that the tax and the return are due on a quarterly basis. Second, if a third party fails to pay the amount charged for the disposal of waste tonnage and an owner or operator has deducted that amount from gross income as a bad debt, then the owner or operator may deduct the amount of that tonnage if the tax was paid on the tonnage. If the owner or operator is not subject to income tax, the owner or operator may take the deduction when it is determined that the charges are not collectible. Finally, the act excludes a city or county from receiving proceeds if it does not provide solid waste management programs and services and is not responsible by contract for payment, unless the city or county is served by a regional solid waste management authority. If the city or county is served by the authority, then the city or county must forward the amount of proceeds it receives to that authority. To assist the Department with distribution, the Department of Environment and Natural Resources must provide the Department with a list of cities and counties that are excluded by May 15 of each year.

In S.L. 2007-323, the General Assembly increased the excise tax levied on OTP from 3% to 10%, effective October 1, 2007, with the Secretary of Revenue remitting the additional tax to the University Cancer Research Fund. This act permits wholesale and retail dealers who possess unsalable OTPs to return them to the manufacturer and apply for a refund of the excise tax paid on them. A similar provision already exists for cigarettes and cigars. The act also conforms the discount and refund provisions for OTPs and cigarettes.

TOLL ENFORCEMENT AUTHORITY CHANGES.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-225	**SB 1697**	**Senator Jenkins**

AN ACT TO PROVIDE FOR THE ENFORCEMENT OF TOLLS ON TURNPIKE PROJECTS OF THE NORTH CAROLINA TURNPIKE AUTHORITY, TO MODIFY LAWS APPLICABLE TO THE NORTH CAROLINA TURNPIKE AUTHORITY, AND TO CLARIFY THE AUTHORIZATION MADE IN A PRIOR LAW TO TOLL AN EXISTING SEGMENT OF N.C. 540.

OVERVIEW: This act provides for the enforcement of tolls at toll facilities operated by the North Carolina Turnpike Authority and clarifies the authorization made in a prior law to toll an existing segment of NC 540.

FISCAL IMPACT: No estimate available.

EFFECTIVE DATE: The majority of the provisions of the act became effective when the act was signed into law by the Governor on July 18, 2008.

ANALYSIS: This act addresses four areas pertaining to the North Carolina Turnpike Authority. First, it clarifies the authority to toll the specific segment of NC 540 for which the prohibition on tolling was lifted in 2006. Second, it establishes the procedure for the collection and enforcement of tolls by the Authority. Third, it treats documents and bids on contracts for a toll road the same as those for other roads with respect to confidentiality, registration of maps, and resolution of construction claims. Fourth, it exempts the Authority from the purchase and contract statutes that apply to other State agencies and from rulemaking, except as provided for contesting liability for unpaid tolls.

In 2002, the General Assembly established the North Carolina Turnpike Authority as an independent agency responsible for toll roads and designated the toll road projects. Current law enables the Turnpike Authority to set and collect tolls on Turnpike projects, but it does not establish any procedures for the collection or enforcement of the tolls.

The method by which the Authority plans to impose tolls is through an 'open road' tolling system. Under this system, there are no toll booths and drivers do not have to stop to pay the toll. Vehicles are identified electronically by means of transponders[238] and cameras. Tolls are collected by debiting a prearranged account, by payment by the driver at a facility off the tolled roadway, or by sending the driver a bill for the unpaid toll. The act requires the Authority to post signage notifying drivers that they are approaching a highway for which a toll is required and indicating the methods by which the toll must be paid. The Authority must also operate a facility within the immediate vicinity of the Turnpike project that accepts cash payment of the toll.

The act requires tolls for the same class of vehicle to be the same, but allows a discount of up to 35% of the amount of the toll for vehicles that have transponders. The person who is the registered owner of a vehicle is responsible for a toll unless the owner can establish that the vehicle was in the care, custody, or control of another when the vehicle incurred the toll.

If a toll is not paid within 15 days of when it is incurred, the Authority sends the owner of the vehicle a bill for the toll. The owner has 30 days to pay the bill. If the bill is not paid within 30 days, a processing fee is added to the amount the person owes. The Authority must set the processing fee at an amount that does not exceed the costs of identifying the owner of a motor vehicle that is subject to an unpaid toll and billing the owner for the unpaid toll. The maximum processing fee for a billing period may not exceed $6. A person may not be charged more than $48 in processing fees in a calendar year. A person who receives one or more bills for unpaid tolls during a six-month period and who has not paid the amount due on those bills within

[238]An automatic device that transmits a predetermined message or generates a signal in response to a predefined signal.

30 days after the end of the six-month period is subject to a civil penalty of $25. Only one civil penalty may be assessed for a six-month period.

If the amount of unpaid tolls remains unpaid after 30 days, the Authority will notify the Division of Motor Vehicles that the toll, fee, and penalty have not been paid and the Division will block the renewal registration of the vehicle until the amount is paid. A person whose motor vehicle registration renewal is blocked due to unpaid tolls, processing fee, or civil penalties may pay the amount due to the Division when renewing the vehicle's registration so that the block may be removed. The Division must remit the revenue received to the Authority. The Division's costs of collecting the tolls, fees, and penalties are considered a necessary expense of the operation of the Authority and the Authority must reimburse the Division for these costs.

The act establishes an administrative review process for contested tolls. A person who disputes liability for a toll may, within 30 days after receiving the bill, request a review by the Authority. If after the informal review process, the Authority determines the person is liable for the toll, the person may contest this determination by filing a petition for an administrative hearing at the Office of Administrative Hearings (OAH). Judicial review of an administrative decision by OAH is on the record.

Under current law, it is an infraction for the operator of a motor vehicle to willfully cover or conceal the numbers on a registration plate for the purpose of interfering with the taking of a clear photograph by a traffic control system, such as the 'red-light cameras'. This act adds toll collection systems to this offense, effective December 1, 2008.

In 2006, the General Assembly removed the prohibition on tolling existing roads with respect to a segment of existing NC 540. The 2006 change, however, did not include the identified segment of NC 540 in the group of 'Turnpike Projects' for which a toll can be imposed. Therefore, this act also clarifies the authority of the Turnpike Authority to toll a segment of NC 540 in Wake County that has already been constructed.

2007

BONDS - EXPAND SPECIAL PURPOSE PROJECTS.

Session Law	*Bill #*	*Sponsor*
S.L. 2007-128	**SB 966**	**Senator Cowell**

AN ACT TO AUTHORIZE THE NORTH CAROLINA CAPITAL FACILITIES FINANCE AGENCY TO ISSUE BONDS FOR SALVAGE CENTERS, CERTAIN RESEARCH FACILITIES, AND INTERNATIONAL HEADQUARTERS OF NONPROFIT SCHOLARLY SOCIETIES.

OVERVIEW: This act adds three projects to the list of special projects for which the North Carolina Capital Facilities Financing Agency may issue bonds:

- Facilities for the provision of material salvage and recycling services, the proceeds of which are used to provide for low, moderate, or affordable housing.
- Facilities for the provision of research conducted by a nonprofit corporation organized by two or more accredited universities whose main campuses are located in North Carolina.
- Facilities for housing the international headquarters of a nonprofit scholarly society that is a member of the Scholarly Societies Project.

FISCAL IMPACT: Minimal impact. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2007 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective when signed into law by the Governor on June 27, 2007.

ANALYSIS: A private entity may obtain conduit financing under the Private Capital Facilities Finance Act from the North Carolina Capital Facilities Finance Agency[1] in order to acquire, construct, and improve a qualifying project. In a conduit financing, a governmental entity issues its bonds to finance facilities for a private party, then receives payments from the private party to service the bonds. The interest on the financing to the investor may be exempt from income tax under federal law if the entity is a 501(c)(3) organization and is exempt from income tax under State law under G.S. 159D-55. The advantage to private entities of tax-exempt financing is that interest rates on tax-exempt financing are significantly lower than on taxable financing. The financing agreement could include revenue bonds or some other forms of debt. The private entity must pay for the entire cost of the financing and of the facility being financed. In no event may the financing pledge the faith or credit of the State, a local government, or any political subdivision.

Projects that qualify for conduit financing under the Act include educational facilities, student housing facilities and special purpose projects as defined in G.S. 159C-3(15a). The term 'special purpose projects' includes water systems, sewage disposal systems, public transportation systems, public parking lots, auditoriums, convention centers, recreational facilities, solid waste

[1] Conduit financing is administered by the North Carolina Capital Facilities Financing Agency. The Agency is composed of seven members and is located in the Treasurer's Office. The Agency is audited annually and submits an annual report to the Governor and the General Assembly.

disposal and recycling facilities, housing facilities for children or disabled persons, and facilities for rehabilitation services for disable persons. This act adds the following three projects to the list of projects defined as 'special purpose projects' under G.S. 159C-3(15):

- Facilities for the provision of material salvage and recycling services, the proceeds of which are used to provide for low, moderate, or affordable housing. Habitat for Humanity would meet this description. It operates Reuse Centers across the State where it sells new, used, and recycled building materials to the public and uses the proceeds for low, moderate, and affordable housing. There are five major reuse centers in the State. The reuse center in Wake County is planning to construct a reuse center, which includes administrative offices. The cost of the center is anticipated to be at least $4 million. If Habitat for Humanity is able to finance the construction of the facility through the North Carolina Capital Facilities Financing Agency, it will save tens of thousands of dollars. A similar organization, The Goodwill Industries, is already included in the list of special projects for which the Agency may issue bonds.
- Facilities for the provision of research conducted by a nonprofit corporation organized by two or more accredited universities whose main campuses are located in North Carolina. RTI International would meet this description. Currently, RTI International rents facility space. In the long-term, RTI will save money if it purchases its own facilities.
- Facilities for housing the international headquarters of a nonprofit scholarly society that is a member of the Scholarly Societies Project.[2] To be included in the Project, a society must generally be a membership-based society that has scholarly, academic, or research goals. The only scholarly society that is a member of the Project and has its international headquarters located in North Carolina is Sigma Xi. Sigma Xi, founded in 1886, is the international honor society of research scientists and engineers. The society currently owns a 52,000 square foot facility in the Research Triangle Park.

2007 CONTINUING BUDGET AUTHORITY.

Session Law	*Bill #*	*Sponsor*
S.L. 2007-145	**HB 2044**	**Rep. Luebke, Gibson, Wainwright, Weiss**

AN ACT AUTHORIZING THE DIRECTOR OF THE BUDGET TO CONTINUE EXPENDITURES FOR THE OPERATION OF GOVERNMENT AT THE LEVEL IN EFFECT ON JUNE 30, 2007; APPROPRIATING FUNDS FOR INCREASES IN THE AVERAGE DAILY MEMBERSHIP IN THE PUBLIC SCHOOLS; EXTENDING THE PROVISION THAT PERMITS RETIRED TEACHERS TO RETURN TO THE CLASSROOM WITHOUT A LOSS OF RETIREMENT BENEFITS; DELAYING THE EFFECTIVE DATE OF CHANGES TO THE MEDICAID ESTATE RECOVERY PLAN; AND EXTENDING THE SUNSET ON THE ADDITIONAL ONE-QUARTER CENT STATE SALES AND USE TAX FROM JULY 1, 2007, UNTIL AUGUST 1, 2007.

[2] The Scholarly Societies Project provides access to information about a significant number of scholarly societies worldwide.

OVERVIEW: Among other things, this act extended the sunset on the additional ¼ cent State sales tax rate from July 1, 2007, until August 1, 2007.

FISCAL IMPACT: The one-month extension of the sales tax rate at 4.25% resulted in an increase to the General Fund of roughly $20 million. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2007 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The act became effective when signed into law by the Governor on July 29, 2007.

ANALYSIS: Section 9 of the act extended the sunset on the additional ¼ cent State sales tax rate until August 1, 2007. The extension kept the State sales tax rate at 4.25% until August 1, 2007. S.L. 2007-323 repealed the August 1, 2007, sunset, thus retaining the 4.25% State sales tax rate permanently.

The General Assembly increased the State sales tax rate from 4% to 4.5% in 2001. The increase was to sunset July 1, 2003. S.L. 2003-284 extended the sunset for two years to July 1, 2005. S.L. 2005-276 extended the sunset an additional two years to July 1, 2007. S.L. 2006-66 reduced the rate by ¼ cent earlier than was required under S.L. 2005-276 so that the State sales tax rate became 4.25%, effective December 1, 2006, with the tax rate expected to return to 4%, effective July 1, 2007. This act extended the 4.25% rate until August 1, 2007.

REVISED DIST. OF SCRAP TIRE DISPOSAL TAX.

Session Law	*Bill #*	*Sponsor*
S.L. 2007-153	**SB 1472**	**Senator Albertson**

AN ACT TO AMEND THE DISTRIBUTION OF THE PROCEEDS OF THE SCRAP TIRE DISPOSAL TAX TO INCREASE FUNDS ALLOCATED TO COUNTIES FOR THE DISPOSAL OF SCRAP TIRES, TO INCREASE FUNDS ALLOCATED TO THE SOLID WASTE MANAGEMENT TRUST FUND, AND TO DECREASE FUNDS ALLOCATED TO THE SCRAP TIRE DISPOSAL ACCOUNT.

OVERVIEW: This act, which was a recommendation of the Department of Environment and Natural Resources, amends the distribution of the net proceeds of the Scrap Tire Disposal Tax; it does not change the tax rate. It increases the percentage of net tax proceeds distributed to the Solid Waste Management Trust Fund from 5% to 8%, decreases the percentage distributed to the Scrap Tire Disposal Account from 27% to 22%, and increases the percentage distributed among the counties on a per capita basis from 68% to 70%.

FISCAL IMPACT: No impact. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2007 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective July 1, 2007.

ANALYSIS: In the late 1980s, the General Assembly banned the landfilling of whole scrap tires and required each county to develop disposal procedures for scrap tires located within its boundaries. The Scrap Tire Disposal Tax, enacted in 1991, is a privilege tax levied on the retail sales of new tires for the purpose of providing a source of revenue to assist with their disposal.[3] The rate of tax depends upon on the size of the tire. It is 2% for tires that have a bead diameter

[3] The tax is administered in the same manner as the State sales and use tax. The tax is also imposed on sales to wholesale merchants or retailers for placement of tires on a vehicle offered for sale, lease, or rental.

of less than 20 inches and 1% for tires that have a bead diameter of 20 inches or more.[4] Sales of bicycle tires, recapped tires, and tires sold for placement on newly manufactured vehicles are exempt from the tax.

The net proceeds[5] of the tax are distributed among the Solid Waste Management Trust Fund, the Scrape Tire Disposal Account, and the counties. This act changes the distribution of the net proceeds of the tax revenue to more accurately reflect the current needs for the funding: less funding is needed for the cleanup of illegal or nuisance dump sites and more funding is needed by the Solid Waste Management Trust Fund to encourage market development and by counties to improve their ongoing disposal programs.

The act changes the distribution as follows:

- Increases from 5% to 8% the amount of the net tax proceeds credited to the Solid Waste Management Trust Fund. Monies in the Fund are used to promote waste reduction and recycling, research on the solid waste stream in North Carolina, and activities related to the development of secondary materials markets.
- Decreases from 27% to 22% the amount of the net tax proceeds credited to the Scrap Tire Disposal Account. Monies in the Account may be used to provide grants to local governments to assist them in disposing of scrap tires[6] provide grants to encourage the use of processed scrap tire materials, and clean up scrap tire collection sites.
- Increases from 68% to 70% the amount of the net tax proceeds distributed to the counties on a per capita basis, based on the most recent annual population estimates certified by the State Budget Officer.

STREAMLINED SALES TAX CHANGES.

Session Law	*Bill #*	*Sponsor*
S.L. 2007-244	**HB 257**	**Representative Hill**

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

OVERVIEW: This act, which was a recommendation of the Revenue Laws Study Committee, does the following:

- It 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.

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[4]The bead is that part of the tire that contacts the wheel. The bead is reinforced with steel wire, and compounded from high strength, low flexibility rubber. The bead seats against the wheel tightly to ensure that the tire holds air without leakage.

[5] The Department of Revenue retains $425,000 annually from the proceeds of the tax for administrative expenses. (S.L. 2007-323 increased this amount from $225,000 to $425,000, effective July 1, 2007.)

[6] By providing additional funding to the counties directly, the adjustment will also reduce the need for supplemental grants from the Scrap Tire Disposal Account.

FISCAL IMPACT: Minimal impact. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2007 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective October 1, 2007.

ANALYSIS: This act makes two definitional changes in the sales tax laws to maintain compliance with the latest amendments to the Streamlined Sales and Use Tax Agreement (Agreement). First, it adds a definition of 'bundled transaction' and specifies how these transactions are to be taxed. Second, it modifies the definition of 'sales price' to clarify how third-party discounts, such as a manufacturer's coupon, affect the sales price of an item.

Bundled Transactions

The lack of uniformity among states in the taxation of bundled transactions led to the development of principles of taxation for bundled transactions in the Agreement. A 'bundled transaction' is the sale of an exempt product and a taxable product for one price.[7] It does not include a sale of two or more products whose combined price varies, or is negotiable, depending on the products a purchaser selects. For tangible products, the bundle is taxable based on the sales price of the bundle unless it meets either the 50% test or the 10% test.

The 50% test applies to bundles of tangible products that include food or medical items that are exempt from State tax. Under the 50% test, if at least 50% of the price of the products in the bundle is attributable to food or medical items that are exempt from State tax, then the bundle is not subject to State sales tax. The bundle is also exempt from 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.

The 10% test applies to all other bundles of tangible products. Under the 10% test, if no more than 10% of the price of the products in the bundle is attributable to taxable items, then the bundle is not subject to State or local sales tax.

For services, the bundle is subject to the 10% test, but it 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* 10% threshold.

Sales Price

The act amends the definition of 'sales price' to specify when a manufacturer's discount or other discount is considered part of the sales price. Previous law excluded some discounts from the definition of sales price but did not address the subject as fully as the change in the act. A price discount is part of the sales price if the retailer receives reimbursement from a third-party in the amount of the discount. The act does not change the application of the law on this subject.

Commercial Fishing

The act allows the holder of a commercial fishing license, the holder of commercial shellfish license, and the operator of a for-hire boat to qualify for a sales tax exemption for items sold

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[7] Under previous law, the sales price of a bundle of tangible products was taxable. With respect to services, previous law permitted the application of tax to part of the sales price, based on the allocation of revenue to the taxable services in the bundle.

for use in commercial fishing. While for-hire boat operators were not referenced specifically in the prior statute, the administrative practice of the Department of Revenue had been to allow their use of the exemption.

Clarifying and Technical Changes

Section 1 of the act updates the reference to the Streamlined Sales Tax Agreement to June 23, 2007, to include the latest amendments of the Agreement. Section 5 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.[8]

MODIFY TAX ON PROPERTY COVERAGE CONTRACT.

Session Law	*Bill #*	*Sponsor*
S.L. 2007-250	**SB 238**	**Senator Kerr**

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.

OVERVIEW: This act does four things:

- It reduces the additional tax rate applicable to gross premiums on insurance contracts for property coverage from 0.85% to 0.74%, effective January 1, 2008.
- It increases from 20% to 50% the percentage of the tax proceeds derived from the additional fire and lightning tax rate allocated to the Volunteer Fire Department Fund. 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.
- 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: The act increases the amount of funds allocable to the Volunteer Fire Department Fund and reduces accordingly the funds credited to the General Fund. The estimated loss to the General Fund, and consequential gain to the Volunteer Fire Department Fund, is $1.49 million for FY07-08 and $3.07 million for FY08-09. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2007 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The act became effective January 1, 2008.

[8] This is the same result as under previous law because the database is a written statement of the Department under G.S. 105-264.

ANALYSIS: North Carolina imposes a 1.9% tax rate on the gross premiums of most insurance policies.[9] 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,[10] 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.[11] The net proceeds of this tax are credited to the Department of Insurance and most of the proceeds are distributed to the fire districts.[12]

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 set the percentages for the 2007 taxable year in the statute[13] 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, there will be one additional rate applicable to policies covering all types of property damage, not just fire and lightning coverage. The reason for expanding the base to include all types of property coverage is that volunteer fire departments must respond to more than just fire calls; they are often the first responders to many types of calls that involve property damage. To keep the changes revenue neutral, the legislation reduced the tax rate from 1.33% to 0.85%, and it directed the Revenue Laws Study Committee to continue studying this issue to ensure a revenue neutral tax rate.

The base broadening of the 2006 legislation also eliminated the 0.5% tax imposed on contracts of insurance applicable to fire and lightning coverage within fire districts. By applying the tax broadly, it made unnecessary the accounting by insurance companies of the amount of premiums written in fire districts. The removal of this accounting greatly reduces the administrative compliance burden for the companies. 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.

Based upon the recommendation of the Revenue Laws Study Committee to the 2007 General Assembly, this act makes the following changes to the law:

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[9] Workers' compensation policies are taxed at 2.5%.

[10] 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.

[11] Prior to January 1, 2008, the 1.33% State rate did not apply to marine and automobile policies.

[12] 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.*

[13] Fire loss, 100% of policy taxable; homeowners, 50% taxable; farm owners, 30% taxable; non-liability portion of commercial multiple peril, 100%, liability portion of commercial multiple peril, 0%.

- It reduces the additional tax rate on property coverage contracts from 0.85% to 0.74% to ensure a revenue neutral tax rate. It also 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 result in fire districts receiving significantly different distribution amounts. The act changes the distribution formula so that the amounts distributed under it more closely follow the current distribution patterns. Under the new distribution formula, the Insurance Commissioner will allocate to each county the amount of tax proceeds it received in the previous year. From that amount, the Commissioner will distribute to each fire district in the county the amount it received in the previous year. If the amount of proceeds to be allocated varies from the amount allocated the previous year, then the amount allocated to a county will be either reduced or increased by a percentage, the numerator of which is the population of the county and the denominator of which is the population of the State. If the amount to be distributed to the fire districts differs from the amount distributed the previous year, then the amount distributed will be either reduced or increased by a percentage, the numerator of which is the tax value of the property located in the district and the denominator of which is the tax value of all property located in any fire district in that county.
- 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 from $20,000 to $30,000 the cap on the grants from the Volunteer Fire Department Fund. It also changes in the following ways the qualifications for grants from the Fund so that more volunteer fire departments may qualify for grants:
    - 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 (was 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 (was three).

PROPERTY TAX COMMISSION TERMS.

Session Law	*Bill #*	*Sponsor*
S.L. 2007-308	**HB 1555**	**Representative Owens**

AN ACT PROVIDING FOUR-YEAR TERMS FOR ALL APPOINTMENTS TO THE PROPERTY TAX COMMISSION.

OVERVIEW: This act provides that the terms of the members of the Property Tax Commission are for four years and expire on June 30.

FISCAL IMPACT: No impact. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2007 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective when signed into law by the Governor on July 28, 2007, and applies to appointments made on or after July 1, 2007.

ANALYSIS: This act provides that all members appointed to the Property Tax Commission will serve four-year terms expiring on June 30. The Property Tax Commission consists of five members, three of whom are appointed by the Governor and two of whom are appointed by the General Assembly. Of the two appointments by the General Assembly, one is made upon the recommendation of the Speaker of the House and the other is made upon the recommendation of the President Pro Tempore of the Senate. Prior to this act, all appointees served four-year terms, except the member appointed upon the recommendation of the Speaker of the House. That member served a two-year term.

The Property Tax Commission is the five-member State board of equalization and review that hears and decides taxpayers' administrative appeals from decisions concerning the listing, appraisal, or assessment of property made by county boards of equalization and review and boards of county commissioners. The Commission also hears appeals from orders of boards of county commissioners adopting schedules of values, standards, and rules. The Commission must meet at least once in each quarter and may hold special meetings at any time and place within the State at the call of the Chair or upon the written request of at least three members. The Chair is designated by the Governor and serves at the pleasure of the Governor. The expenses of the Commission do not come from the General Fund but are paid by local governments.[14] The Commission is authorized to set the salary for its members. Currently, members receive $400 a day for their work on the Commission, and the Chair receives $450 a day.[15]

CONSERVATION TAX CREDIT MODIFICATIONS.

Session Law	*Bill #*	*Sponsor*
S.L. 2007-309	**HB 463**	**Representative Luebke**

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

OVERVIEW: This act does four things:

- It equalizes the cap for the conservation tax credit for corporations and pass-through entities at $500,000.
- It requires a taxpayer claiming the credit to support the claim's represented value of the real property donation.
- It narrows the conservation purposes that qualify property for the credit.
- It provides that a married couple filing jointly is entitled to the same tax credit cap as two unrelated individuals making an equivalent donation of property.

FISCAL IMPACT: There is not sufficient data available for an accurate assessment of the overall fiscal impact from the changes in this act. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2007 Session. Available in the Legislative Library.)*

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[14] The Department of Revenue collects local sales taxes on behalf of local governments and distributes the proceeds quarterly. In making these distributions, the Department is required under G.S. 105-501 to deduct the State's costs relating to local property tax administration, the Property Tax Commission, the School of Government's property tax training program, and the Local Government Commission.

[15] Section 7.11 of S.L. 2000-67 provides that members receive travel, subsistence, and salary while being trained and clarifies that those members should receive salary and reimbursement while deciding, as well as hearing, cases.

EFFECTIVE DATE: The act is effective for taxable years beginning on or after January 1, 2007.

ANALYSIS: The General Assembly first enacted the conservation income tax credit in 1983. The credit is allowed to a taxpayer that donates real property useful for public beach access or use, public access to public waters or trails, fish and wildlife conservation, or other similar land conservation purposes. To qualify for the credit, 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. 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.[16]

The Revenue Laws Study Committee reviewed the credit. This act addresses some of the issues identified by the Committee.

Application of dollar limitation. – The act makes two adjustments to the tax credit cap:

- Pass-through entities. – The act equalizes the cap for the conservation tax credit for corporations and pass-through entities at $500,000 by increasing the existing dollar limitation for pass-through entities from $250,000 to $500,000.[17] The higher dollar limitation for a pass-through entity will provide a greater incentive for the multiple owners of a pass-through entity to donate property. Each individual who is an owner of a pass-through entity is allowed a credit equal to the owner's allocated share of the credit to which the pass-through entity is eligible, subject to the individual credit cap of $250,000. When an owner's share of the pass-through entity's credit is limited due to the $250,000 individual credit cap, the pass-through entity and its owners may not reallocate the unused credit among the other owners.

- Married couples. – The act clarifies that the dollar limitation for a married couple filing jointly is $500,000.

The dollar limitation for the initial credit in 1983 was $5,000 for all taxpayers. In 1997, the General Assembly created two different caps: $100,000 for individuals and $250,000 for corporations. In the case of a pass-through entity, the dollar limitation applied to each individual member of the pass-through entity rather than to the pass-through entity itself. The General Assembly increased the dollar limitations to their current amounts in 1999: $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 rather than as to each individual member.[18] The bill enacted by the General Assembly, S.L. 2001-335, excluded the conservation tax credit from the general rule found in G.S. 105-269.15 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. This exception for the conservation tax credit was originally set to expire in 2005; however, the sunset was extended twice, preserving the unique application of the cap for the conservation tax credit until it expired

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[16] The higher dollar limitation for corporations reflects the fact that corporations are prohibited from claiming both a tax deduction and a tax credit for the same donation. However, individuals may take a charitable contribution deduction as well as the tax credit for the same donation.

[17] The act makes a technical change to the language of G.S. 105-130.34 to refer specifically to C Corporations, since G.S. 105-151.12 deals with pass-through entities, including S Corporations.

[18] Doing so brought North Carolina into conformity with how federal law allowed pass-through entities to take tax credits. See G.S. 105-269.15.

on January 1, 2007. Prior to the enactment of this act, a pass-through entity claiming the conservation tax credit in 2007 would have been limited to a cap of $250,000 and that amount would have been allocable among its owners in proportion to their ownership interest.

Accuracy of valuation. – The act addresses valuation concerns of donated property by requiring the use of certain types of supported appraisal reports or the county's appraisal value. These concerns, reported by the Department of Revenue, stem from the use of restricted appraisal reports that are compiled specifically for one person and contain little or no information relied upon by the appraiser to formulate the property's value and the lack of any requirement under the prior law of specific documentation useful for establishing the fair market value of the donation. Under prior law, a taxpayer was required to file with the income tax return a certification by the Department of Environment and Natural Resources (DENR) that the property is suitable for the statutorily listed conservation purposes. DENR did not review the documentation in an effort to verify the taxpayer's representation as to the fair market value of the donated property interest.

The act addresses this valuation concern by requiring a taxpayer to support a claim for a credit with 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.

Clarification of conservation purposes. – The act reduces uncertainty with respect to the types of uses that qualify for conservation purposes by substituting specific uses in place of the catch-all phrase 'other similar land conservation purposes'. Differences in the statutory construction of the phrase, 'other similar land conservation purposes' developed between DENR and the Department of Revenue. The act eliminates the phrase and substitutes 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.

2007 APPROPRIATIONS ACT.

Session Law	*Bill #*	*Sponsor*
S.L. 2007-323, as amended by S.L. 2007-345	**HB 1473, as amended by HB 714**	**Rep. Michaux, Crawford, Yongue**

AN ACT TO MAKE BASE BUDGET APPROPRIATIONS FOR CURRENT OPERATIONS OF STATE DEPARTMENTS, INSTITUTIONS, AND AGENCIES, AND FOR OTHER PURPOSES.

OVERVIEW: This act authorizes special indebtedness for various higher education and State facilities, increases various fees to provide revenue necessary to fund receipt-supported services, and makes the following tax law changes:

Section & Effective Dates	Description	Fiscal Impact
Individual & Corporate Income Tax Changes		
31.1 *Effective 1/1/2007*	**IRC Update** – Updates the reference to the Internal Revenue Code to January 1, 2007, which effectively makes the following changes: • Extends the enhanced small business expensing thresholds. • Extends the deduction for higher education expenses. • Extends the deduction for qualified expenses of elementary and secondary school teachers. • Excludes up to $3,000 of otherwise taxable distributions from a government pension plan of retired public safety officers when the money is used to pay for health insurance premiums.	FY 2007-08 $56.9 million loss FY 2008-09 $49.1 million loss FY 2009-10 $14.4 million loss FY 2010-11 $14.1 million loss
31.4 *Effective 1/1/2008* *Expires 1/1/2013*	**Earned Income Tax Credit** – Establishes a refundable State EITC equal to 3.5% of an individual's federal EITC.	FY 2008-09 $48.3 million loss FY 2009-10 $48.3 million loss FY 2010-11 $48.3 million loss FY 2011-12 $48.3 million loss
31.5 *Effective 1/1/2007* *Expires 1/1/2013*	**Reenact Long-Term Care Credit** - Subject to an income limitation, allows a taxpayer to receive a credit equal to 15% of the premium paid each year on a long-term care insurance policy, with a cap of $350 per policy. The prior credit expired in 2004.	FY 2007-08 $7.0 million loss FY 2008-09 $7.2 million loss FY 2009-10 $7.3 million loss FY 2010-11 $7.5 million loss FY 2011-12 $7.7 million loss
31.6 *Effective 1/1/2007* *Expires 1/1/2013*	**Adoption Tax Credit** – Establishes a nonrefundable credit for adoption-related expenses equal to 50% of the federal adoption credit amount. The amount is reduced based upon a taxpayer's modified AGI.	FY 2007-08 $3.0 million loss FY 2008-09 $3.0 million loss FY 2009-10 $3.0 million loss FY 2010-11 $3.0 million loss FY 2011-12 $3.0 million loss
31.18 *Effective 1/1/2007*	**REIT Provision** - Limits a corporation's ability to use captive real estate investment trusts (REITs) to avoid State taxes by disallowing the dividend paid deduction when a REIT is a captive REIT.	No discernible impact.

Section & Effective Dates	Description	Fiscal Impact
31.19 *Effective 1/1/2007*	**Enhance 529 Plan Income Tax Deduction** -Changes the current income tax deduction for contributions to the Parental Savings Trust Fund as follows: • It removes the January 1, 2011 sunset. • It increases the maximum annual deduction amount allowable from $2,000 to $2,500 single filers and from $4,000 to $5,000 for married couples filing jointly. • It removes the income limitations for taxable years 2007 through 2011.	FY 2007-08 $0.2 million loss FY 2008-09 $0.2 million loss FY 2009-10 $0.2 million loss FY 2010-11 $0.2 million loss FY 2011-12 $0.2 million loss
31.21 *Effective 1/1/2007*	**Work Opportunity Tax Credit** – Establishes an income tax credit for a taxpayer who is allowed a Work Opportunity Tax Credit (WOTC) under the IRC. The amount of the credit is equal to 6% of the amount of credit allowed under the Code. The credit allowed may not exceed 50% of the tax against which it is claimed, and any unused portion of the credit may be carried forward for five years.	FY 2007-08 $3.0 million loss FY 2008-09 $3.0 million loss FY 2009-10 $3.0 million loss FY 2010-11 $3.0 million loss FY 2011-12 $3.0 million loss
31.24 *Effective 1/1/2007*	**Firefighter/Rescue Squad Tax Deduction** – Establishes a $250 income tax deduction for a person who works as an unpaid member for a volunteer fire department, volunteer rescue department, or an EMS squad and attends at least 36 hours of training during the year.	FY 2007-08 $10.5 million loss FY 2008-09 $10.7million loss FY 2009-10 $10.8 million loss FY 2010-11 $11.0 million loss FY 2011-12 $11.2 million loss
Effective 1/1/2008	**Expiration of Upper Income Tax Bracket**[19] **–** Under current law, the upper income tax rate is 8% for tax year 2007. This rate is scheduled to be eliminated in 2008. As part of its overall budget package, the General Assembly decided not to extend the sunset. Thus, the current 8% upper income tax bracket will expire in 2008. Beginning with tax year 2008, the top rate will be 7.75%.	The fiscal impact of this item is considered to be zero since it is allowing a tax to sunset.

[19] There was no legislative action taken during the 2007 Session to effectuate this change.

Section & Effective Dates	Description	Fiscal Impact
Sales Tax Changes		
31.2 *Effective 7/31/2007*	**Maintain Current Sales Tax Rate** – Makes permanent the State sales tax rate at 4.25%.	FY 2007-08 $258.4 million gain FY 2008-09 $285.9 million gain FY 2009-10 $299.2 million gain FY 2010-11 $312.6 million gain FY 2011-12 $326.7 million gain
31.14 *Effective 10/1/2007*	**Amend Sales Tax Holiday –** Provides that school instructional materials with a sales price of $300 or less are exempt from sales tax during the first weekend of August.	
Economic Incentives		
31.7 *Effective 10/1/2007*	**Privilege Tax on Software Publishers' Machinery & Equipment** – Reduces the tax paid on certain purchases of machinery and equipment by software publishing companies by exempting those purchases from the 6.75% sales tax and imposing a 1% privilege tax on the sales prices, subject to an $80 cap.	FY 2007-08 $2.8 million loss FY 2008-09 $4.0 million loss FY 2009-10 $4.0 million loss FY 2010-11 $4.0 million loss FY 2011-12 $4.1 million loss
31.8 *Effective 1/1/2007*	**Enhance Tax Credit for R & D Expenditures** – Expands the existing tax credit for taxpayers with qualified research and development expenses. The amount of the credit is equal to a percentage of the qualifying expenses and varies depending upon the size and tier location of the business.	FY 2007-08 $0.4 million loss FY 2008-09 $0.8 million loss FY 2009-10 $1.2 million loss FY 2010-11 $1.2 million loss FY 2011-12 $1.2 million loss

Section & Effective Dates	Description	Fiscal Impact
31.9 *Effective 1/1/2007*	**Modify Tax Credit for Constructing Renewable Fuel Facilities** – Modifies the enhanced credit for constructing renewable fuel production facilities as follows: • The credit may be claimed against the franchise tax as well as the income tax. • A taxpayer who claimed the enhanced tax credit and later fails to meet the requirements of the enhanced credit may take the non-enhanced credit for constructing renewable fuel production facilities. A taxpayer who forfeits the enhanced credit must pay the additional avoided taxes and interest on the avoided taxes from the original due date of the taxes.	FY 2007-08 No impact FY 2008-09 $2.3 million loss FY 2009-10 $4.8 million loss FY 2010-11 $6.8 million loss FY 2011-12 $6.8 million loss
31.10 *Effective 7/31/2007*	**Expand Sales and Use Tax Refund for Certain Aircraft Manufacturers** – Expands the definition of 'aircraft manufacturing' and allows aircraft manufacturers to qualify for a refund of sales and use taxes paid on building materials and supplies, fixtures, and equipment that are installed in the construction of and become part of the real property of the aircraft manufacturing industrial facility. The taxpayer must meet minimum investment thresholds to qualify.	FY 2007-08 $0.8 million loss FY 2008-09 $0.8 million loss FY 2009-10 $0.8 million loss FY 2010-11 $0.8 million loss FY 2011-12 $0.8 million loss
31.20 *Effective 7/31/2007*	**Sales Tax Refund – Research Supplies** – Provides a sales and use tax refund to a taxpayer who is engaged in analytical services in the State. The amount of the refund depends upon the amount by which the tax paid in the fiscal year exceeds the amount paid in fiscal year 06-07.	FY 2007-08 No impact FY 2008-09 $2.6 million loss FY 2009-10 $5.4 million loss FY 2010-11 $5.7 million loss FY 2011-12 $6.0 million loss
31.22 *Effective 10/1/2007*	**Datacenter Sales Tax Exemption** – Reduces the tax paid on certain purchases of machinery and equipment located and used at eligible datacenters by exempting the purchases from the 6.75% sales tax and imposing a 1% privilege tax on the sales price, subject to an $80 cap.	FY 2007-08 No impact FY 2008-09 No impact FY 2009-10 $5.2 million loss FY 2010-11 $7.0 million loss FY 2011-12 $8.7 million loss

Section & Effective Dates	Description	Fiscal Impact
31.23 *Effective 1/1/2007*	**Tax Incentive for Railroad Intermodal Facility** – Establishes a new income tax credit and new sales and use tax exemptions and refunds for a taxpayer who constructs or leases and puts into operation an eligible railroad intermodal facility. To be eligible, the cost of construction of the facility must exceed $30 million.	FY 2007-08 $0.2 million loss FY 2008-09 $0.3 million loss FY 2009-10 $0.9 million loss FY 2010-11 $2.0 million loss FY 2011-12 $2.0 million loss
Excise Taxes		
6.23 *Effective 10/1/2007*	**University Cancer Research Fund** – Increases from 3% to 10% the excise tax on OTP to fund, in part, the University Cancer Research Fund.	FY 2007-08 $11.4 million gain FY 2008-09 $16.5 million gain FY 2009-10 $17.0 million gain FY 2010-11 $17.5 million gain FY 2011-12 $18.1 million gain
31.15 *Effective 7/31/2007*	**Cap the Variable Wholesale Component of the Motor Fuels Tax Rate for Two Years** – Extends the existing cap for two years, capping the variable wholesale component of the motor fuels tax rate at 12.4¢ per gallon for the period July 1, 2007, through June 30, 2009, for a maximum possible rate of 29.9¢ per gallon.	FY 2007-08 $85.8 million loss FY 2008-09 $54.3 million loss
General State & Local Changes		
31.16 *Effective over 3-year period, beginning 10/1/2007*	**State Assume Medicaid Responsibilities** – Provides that the State assumes the counties' share of the nonfederal share of Medicaid costs over a three-year period as set out below. To offset the cost to the General Fund, the third one-half cent local sales tax is phased out and the State sales tax rate is increased by the same amount. 10/1/2007 = 25% 7/1/2008 = 50% 7/1/2009 = 100%	FY 2007-08 $60.8 million loss FY 2008-09 $91.9 million loss FY 2009-10 $146.7 million loss FY 2010-11 $149.5 million loss FY 2011-12 $184.1 million loss

Section & Effective Dates	Description	Fiscal Impact
31.17 *Effective 7/31/2007*	**Local Option County Taxes** – Provides authority for two new local taxes, of which counties may choose to levy only one if a majority of those voting in a referendum vote for the levy of the tax: • Land transfer tax on transfers of land within the county. The rate of tax may be up to .4% of the greater of the value of or consideration paid for the property, and the rate must be an increment of .1%. • A ¼-cent sales and use tax. The rate of tax is .25% of the sales price of the item, in addition to all other State and local sales and use taxes, except for purchases of food exempt from tax under G.S. 105-164.13B. The adoption, levy, collection, administration, and repeal of this sales and use tax are in accordance with the first one-cent local sales and use tax.	No State impact.

FISCAL IMPACT: See **ANALYSIS**. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2007 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: See **ANALYSIS.**

ANALYSIS: The 2007 Appropriations Act made many tax law changes and appropriated funds to be used for economic development, authorized special indebtedness for various higher education and State facilities, and increased various fees to provide revenue necessary to fund receipt-supported services.

Part I: Individual and Corporate Income Tax Changes

IRC update. – Section 31.1 of the act updates the reference to the Internal Revenue Code used in defining and determining certain State tax provisions from January 1, 2006, to January 1, 2007. The section became effective when the Governor signed the act into law on July 31, 2007. The provision is a recommendation of the Revenue Laws Study Committee and was included in the Governor's revenue recommendations. Fiscal Research estimates that conforming to the Code will reduce General Fund availability by $56,900,000 in FY07-08 and by $49,100,000 in FY08-09. Updating the reference to the Code effectively made the following tax policy changes:

- It extends the enhanced small business expensing thresholds.
- It extends the deduction for higher education expenses.

- It extends the deduction for qualified expenses of elementary and secondary school teachers.
- It authorizes the exclusion of up to $3,000 of otherwise taxable distributions from a government pension plan of retired public safety officers when the money is used to pay for health insurance premiums.

North Carolina's tax law tracks many provisions of the federal Internal Revenue Code by reference to the Code. The General Assembly determines each year whether to update its reference to the Internal Revenue Code. 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. Changing the reference date to January 1, 2007, incorporates 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.[20]

Earned income tax credit. – Section 31.4 of the act establishes a refundable State earned income tax credit.[21] The credit is equal to 3.5% of an individual's federal earned income tax credit. It becomes effective for taxable years beginning on or after January 1, 2008, and expires for taxable years beginning on or after January 1, 2013. Fiscal Research estimates that the earned income tax credit will reduce General Fund availability by $48,300,000 in FY08-09.

The Internal Revenue Code provides an earned income tax credit for individuals who work and whose adjusted gross income does not exceed a specified amount. The credit is intended to offset some of the increases in living expenses and social security taxes and provide an incentive for low-income families to work instead of collect welfare. The amount of the credit may exceed the amount of tax owed by the taxpayer. If the credit allowed exceeds the amount of tax imposed, the excess is refundable to the taxpayer.

To be eligible for the credit, an individual must meet the following requirements:

- Have a valid social security number.
- Have earned income from employment or self-employment.
- Be a U.S. citizen, a resident alien all year, or a nonresident alien married to a U.S. citizen or resident alien and filing a joint return.
- Is not a qualifying child of another person.
- Have a qualifying child OR meet the following requirements:
    - Age 25 but under age 65 at the end of the year.
    - Live in the U.S. for more than half the year.

The amount of the federal credit varies depending upon whether the taxpayer has children and the amount of earned income the taxpayer has. The credit is phased out as the taxpayer's

[20] A more detailed summary of the recent amendments to the Code is available upon request.

[21] As of 2006, 20 states offer an earned income tax credit. In most instances, the credit is refundable. North Carolina has three other refundable tax credits: the credit for qualifying expenses of a production company, the credit for low-income housing, and the credit for reinvestment by major recycling facilities.

earned income rises. To qualify for the credit in 2006, an individual's earned income may not exceed $38,348 for an individual who is married filing jointly with two or more qualifying children. The maximum federal credit amount allowed in 2006 is $4,536 for an individual with two or more qualifying children; for North Carolina, the maximum credit amount would be approximately $159. The maximum federal credit amount in 2006 for an individual with no children is $412; for North Carolina the maximum credit amount would be approximately $14. The earned income amounts and the credit amounts are indexed to inflation.

In the 2005 tax year, more than 22 million individuals received $41.4 billion in the federal earned income tax credit. However, the IRS estimates that 20 to 25% of people who qualify for the credit do not claim it. To better ensure taxpayers in North Carolina receive the benefits of the earned income tax credit, Section 24.3 of this act, as amended by Section 14.3 of S.L. 2007-345 (Section 14.3 of HB 714) [22] does two things:

- It requires the Department of Revenue to include information on the earned income tax credit in its printed booklets for the individual income tax return.
- It requests that software companies producing computer programs for tax calculation in North Carolina design the programs to automatically compute an individual's eligibility for the State and federal credit.

Reenact long-term care credit. – Long-term care insurance is designed to protect individuals against the high costs of long-term care. The General Assembly enacted a long-term care insurance tax credit in 1998. It expired in 2004.[23] Section 31.5 of this act reenacts the individual income tax credit for premiums paid on long-term care insurance, effective for taxable years beginning on or after January 1, 2007. The credit expires for taxable years beginning on or after January 1, 2013. Fiscal Research estimates that the credit will reduce General Fund revenues by $7,000,000 in FY07-08 and by $7,200,000 in FY08-09.

The credit amount is equal to 15% of the premium paid each year on a long-term care insurance policy. The credit may not exceed $350 for each policy for which the credit is claimed. The credit differs from the former credit in that to be eligible to claim it a taxpayer's adjusted gross income must not exceed the following amount:

Filing Status	AGI
Married filing jointly	$100,000
Head of Household	$ 80,000
Single	$ 60,000
Married filing separately	$ 50,000

A taxpayer may claim a credit for policies that provide coverage for either the taxpayer, the taxpayer's spouse, or a family member for whom the taxpayer provides over half of the support and whose income is below an exemption amount. The credit may not exceed the amount of tax owed by the taxpayer, and there is no provision to allow unused portions of the credit to be carried forward.

[22] Section 14.3 of S.L. 2007-345 changes the effective date of this administrative provision from January 1, 2007, to January 1, 2008 to conform to the effective date of the new State earned income tax credit.
[23] The Department of Revenue reported in 2001 that 90% of the taxpayers who claimed the credit were not eligible for it. The error rate declined to 27% in 2002 and to 15% in 2003.

Under federal law, premiums paid on long-term care insurance contracts are treated as deductible medical expenses. Under the medical expense itemized deduction, unreimbursed medical expenses may be deducted to the extent that the expenses exceed 7.5% of adjusted gross income. To the extent a taxpayer will receive a deduction for long-term care insurance premiums under the Code, the taxpayer will receive a deduction for State income tax purposes as well since North Carolina uses federal taxable income as the starting point for calculating State taxable income. To prevent a double tax benefit in those cases, the credit is limited to those expenses for which a deduction has not been claimed.

Since 2003, bills to reinstate the credit have been introduced, but until this act, those bills were not enacted. In S.L. 2006-66, the General Assembly directed the Department of Health and Human Services to develop a North Carolina Long-Term Care Partnership Program as an alternative to the tax credit to encourage people to purchase long-term care insurance. This program is a joint effort between states and private insurance companies with a goal of reducing Medicaid expenditures. The Program allows those that purchase long-term care insurance policies to protect some or all of their assets and still qualify for Medicaid. This Program remains in effect.

Adoption tax credit. – Section 31.6 of this act creates an individual income tax credit for adoption related expenses. The amount of the credit is equal to 50% of the taxpayer's federal adoption tax credit amount. The federal adoption tax credit amount may be up to $10,960 per eligible child for the 2006 taxable year. The amount of the credit is reduced based upon the taxpayer's modified adjusted gross income. For the 2006 taxable year, the tax credit phase-out ranges from $164,410 to $204,410. Both the credit amount and the income phase-out ranges are indexed to inflation. The credit may not exceed the amount of tax owed by the taxpayer. However, like the federal tax credit, the State tax credit may be carried forward for five years. The credit is effective for taxable years beginning on or after January 1, 2007, and expires for taxable years beginning on or after January 1, 2013. The Governor included this provision in his budget recommendations. Fiscal Research estimates that the credit will reduce General Fund availability by $3,000,000 in FY07-08 and in FY08-09.

To be eligible for the federal adoption tax credit, a taxpayer must adopt an eligible child and pay qualified adoption expenses. An eligible child is a child 17 years of age or younger or a child of any age who is a U.S. citizen or resident alien and who is physically or mentally incapable of caring for himself or herself. Qualified adoption expenses are calculated by adding up all the expenses directly related to the adoption that are reasonable and necessary for the adoption and subtracting any amounts reimbursed or paid for by an employer, government agency, or other organization. Taxpayers who adopt a special needs child may claim the full amount of the credit without regard to the actual expenses paid.

The year in which a taxpayer may claim the credit depends on when the adoption was finalized and whether the adopted child is a U.S. citizen, resident alien, or a foreign national. If the child is a U.S. citizen or a resident alien, the adoption credit may be claimed for expenses incurred before the adoption is final in the year after the expenses are incurred; it may be claimed in the same year for expenses incurred in the year the adoption is final; and it may be claimed in the year the expenses are incurred if they are incurred in the year after the adoption is final. For a child who is a foreign national, the credit may be claimed in the year the adoption becomes final, or in the year the expenses are incurred if they are incurred in the year after the adoption becomes final. The dollar limit for a particular year must be reduced by the amount of qualifying expenses taken into account in previous years for the same adoption effort.

Alternative for addressing a corporation's attempt to avoid State taxes through the use of a REIT. – Section 31.18 of this act limits a corporation's ability to use captive real estate investment trusts (REITs) to avoid State taxes by disallowing the dividend paid deduction when a REIT is a captive REIT. A REIT is an organization that uses the pooled capital of many investors to purchase and mange real estate. A REIT that is owned or controlled by a single entity is commonly referred to as a captive REIT. Two common types of captive REITs are rental REITs and mortgage REITs.

Under federal and State law, a REIT is taxable only on income that is not distributed to shareholders. The amount of income a REIT distributes is not subject to tax because the REIT is allowed a deduction for the dividends it pays. The amounts received by the shareholders of the REIT are taxable.

In a rental REIT, a corporation that owns real property and uses the property in its business, such as a retail store, forms a REIT and transfers ownership of the property to the REIT. The corporation that operates the store and uses the property makes rental payments to the REIT, which reduces the State income tax liability of the corporation. The REIT is not taxed on the rental income because it is allowed a dividend paid deduction under federal law.

If the corporation receives dividends from the REIT directly, the corporation will pay tax on the dividends it receives. If, however, an affiliated corporation receives the dividends from the REIT and then transfers the dividends to the corporation, the corporation will not pay tax on the amount it receives because it will be able to deduct the amount received from the affiliated corporation under another deduction allowed under federal and state law — the dividend received deduction. If the affiliated company that receives the dividends from the captive REIT is outside the State and has no nexus with the State, the out-of-state holding company will pay no State tax on the income.

As a result of this chain of transfers, the corporation is allowed a deduction for rental expenses, the REIT that receives the rental income is allowed a dividend paid deduction when it distributes the rental income, the out-of-state affiliate that receives the dividend from the REIT is not subject to tax in North Carolina (because of lack of nexus), and the corporation that receives the dividend from its affiliated out-of-state holding company is not subject to tax on the amount it receives because of the dividend received deduction. The corporation has, in effect, been allowed a deduction for its rental expenses and been able to receive the amount it deducted as tax-free income in the form of a dividend received.

In a mortgage REIT, a financial institution forms a REIT and transfers to the captive REIT mortgages or mortgage-backed securities originated by the financial institution. The interest income that would have accrued to the financial institution now accrues to the REIT. The REIT takes the dividend paid deduction when it distributes its income.

The Department of Revenue is aggressively pursuing the closure of this tax avoidance strategy. The Secretary of Revenue has the statutory authority to require a corporate taxpayer to file a consolidated return if the Secretary finds that a separate return filed by the taxpayer does not disclose the true earnings on its business carried on in this State. The Secretary also has the authority to determine the net income of a corporate taxpayer properly attributable to this State if the Secretary has reason to believe the taxpayer's report does not do so. In most instances, this method of addressing a corporation's attempt to use a captive REIT to shift income between entities and avoid State taxes is arduous and litigious.

Section 31.18 of this act provides another method to prevent this tax avoidance strategy. Effective for taxable years beginning on or after January 1, 2007, a captive REIT is not allowed

to take the dividend paid deduction under State law.[24] Instead, the captive REIT is subject to tax on those dividends and the entity that received the dividend from a captive REIT is allowed a dividend received deduction so that the dividend is not taxed twice.

A 'captive REIT' is defined as a REIT whose shares or certificates of beneficial interest are not regularly traded on an established securities market and are owned or controlled, at any time during the last half of the tax year, by a person that is subject to tax under this Part and is not one of the following:

- A REIT.
- A listed Australian property trust. A listed Australian property trust is Australia's version of a U.S. publicly traded REIT.

This section also directs the Department of Revenue to report to the Revenue Laws Study Committee by May 1, 2009, on the amount of corporate income tax revenue generated by closing the captive REIT loophole. Based upon this report, the Revenue Laws Study Committee must determine the revenue-neutral corporate income tax rate and include this information in its report to the 2010 Session of the 2009 General Assembly.

Enhance 529 Plan income tax deduction. – Section 31.19 of this act makes the following three changes to the income tax deduction for contributions made to the Parental Savings Trust Fund, created by the General Assembly last session in S.L. 2006-66:

- It removes the January 1, 2011 sunset of the deduction.
- It increases the maximum annual deduction amount allowable to an individual taxpayer for contributions to the Parental Savings Trust Fund from $2,000 to $2,500. In the case of a married couple filing a joint return, it increases the maximum deduction amount from $4,000 to $5,000.
- It removes the income limitations for taxable years 2007 through 2011.

The changes become effective for taxable years beginning on or after January 1, 2007. Fiscal Research estimates that the changes will reduce General Fund availability by $200,000 for FY07-08 and FY08-09.

In 1996, the General Assembly established the Parental Savings Trust Fund. The Fund is maintained by the State Education Assistance Authority, a political subdivision of the State, and is administered by the College Foundation of North Carolina as agent of the Authority. The Fund was established to enable qualified parents to save funds to meet the costs of the postsecondary education expenses of eligible students. Anyone may contribute to the Fund. Because the Fund meets the qualifications of a qualified tuition program under Section 529 of the Internal Revenue Code, distributions from the Fund are excludable from taxable income to the extent the distributions are used to pay for qualified higher education expenses. Interest earned on the Fund is also tax-exempt.

Every state offers a state Section 529 plan, and at least twenty-five states allow for a full or partial income tax deduction for contributions to the state's own plan. Last session, effective for the 2006 taxable year, the General Assembly enacted legislation that allows an individual taxpayer to deduct from the taxpayer's taxable income an amount contributed by a taxpayer to an account in the State's plan: the Parental Savings Trust Fund. The maximum amount that

[24] Several states have enacted captive REIT legislation similar to these provisions. The states are: Maryland (HB 1257 of the 2007 Session), Kentucky, Indiana, Pennsylvania, Louisiana, and Mississippi.

may be deducted by an individual in the 2006 taxable year was $750; the maximum amount for a married couple filing jointly was $1,500. The maximum deductible amount for the 2007 taxable year was $2,000 for an individual taxpayer and $4,000 for a married couple filing jointly. This act increases the amounts deductible for taxable years beginning on or after January 1, 2007, by $500 to $2,500 and $5,000 respectively.

To qualify for the deduction, the adjusted gross income of the individual taxpayer or married couple filing jointly may not exceed the stated statutory amount. The income limitations of the deduction are the same income limitations a taxpayer must meet to qualify for the higher personal exemption amount and the $75 tax credit for each dependent child. This act removes the income limitation for five years: taxable years 2007 through 2011. Effective for taxable years beginning on or after January 1, 2012, an individual will not qualify for the State tax credit unless the individual's adjusted gross income falls below the statutory limitations.

The Parental Savings Trust Fund deduction must be added back to taxable income if the amount withdrawn from the Fund was not used to pay for qualified higher education expenses of the designated beneficiary. An exception is made if the withdrawal was made due to the death or permanent disability of the beneficiary.

Work Opportunity Tax Credit. – Section 31.21 of this act provides a State income tax credit to a taxpayer who is allowed a Work Opportunity tax credit (WOTC) under the Internal Revenue Code. The amount of the credit is equal to 6% of the amount of credit allowed under the Code. The credit may be claimed against the franchise tax or the income tax. The taxpayer must elect the tax against which a credit will be claimed when filing the return; the election is binding. The credit allowed may not exceed 50% of the tax against which it is claimed. Any unused portion of the credit may be carried forward for five years. The carryforwards must be claimed against the same tax. The credit is effective for taxable years beginning on or after January 1, 2007. The federal credit expires December 31, 2007. Fiscal Research estimates that the credit will reduce General Fund availability by $3,000,000 for FY07-08 and FY08-09.

The WOTC is designed to help move people from welfare into gainful employment and obtain on-the-job experience. On December 20, 2006, the President signed into law the Tax-Relief and Health Care Act of 2006 (P.L. 109-432). This legislation merged the Welfare-to-Work Tax Credit into the WOTC and extended the WOTC program for a two-year period, through December 31, 2007. The current credit applies only to new employees hired on or after January 1, 2007, and before January 1, 2008. The new employee must belong to one of the following nine target groups:

- A member of a family that is receiving or recently received Temporary Assistance to Needy Families (TANF) for at least 18 consecutive months ending on the hiring date.
- A member of a family that is receiving or recently received TANF benefits for any 9-month period during the 18-month period ending on the hiring date.
- An 18 to 39 year old member of a family that is receiving or recently received food stamps.
- An 18 to 24 year old resident of one of the federally designated Empowerment Zones (EZ), Enterprise Communities (EC), or Renewal Communities (RC).
- A 16 to 17 year old EZ/EC/RC resident hired between May 1 and September 15 as a Summer Youth Employee.
- A veteran who is a member of a family that is receiving or recently received food stamps.

- A Vocational Rehabilitation Referral who completed or is completing rehabilitation services from a State certified agency, an Employment Network, or the U.S. Department of Veterans Affairs.
- An ex-felon who has been convicted of a felony and has a hiring date which is not more than one year after the last date on which he was so convicted or released from prison.
- A recipient of Supplemental Security Income benefits.

A new adult employee must work a minimum of 120 or 400 hours and individuals hired as Summer Youth employees must work at least 90 days, between May 1 and September 15, before an employer is eligible to claim the credit. The credit may be as much as $2,400 for each new adult hire, $1,200 for each new Summer Youth hire, and $9,000 for each new long-term family assistance recipient hired over a two-year period. To claim the credit, an employer must seek and receive certification from the IRS that the new employee qualifies the employer for the tax credit.

Firefighter/Rescue Squad Deduction. – Section 31.24 of this act creates a State income tax deduction for an individual who meets all three of the following conditions:

- Works as an unpaid member,
- For a volunteer fire department, a volunteer rescue squad, or an emergency medical services squad,
- And attends 36 hours of training during the taxable year.

The amount of the deduction is $250. An individual may only claim one deduction in a single taxable year.[25] In the case of a married couple filing a joint return, each spouse must qualify separately for the deduction. The deduction is effective for taxable years beginning on or after January 1, 2007. There is no sunset on the deduction. Fiscal Research estimates that the deduction will reduce General Fund availability by $1,000,000 in FY07-08 and in FY08-09.

Expiration of Upper Income Tax Bracket. – In 2001, the General Assembly created a fourth income tax bracket that imposed an additional ½-percent income tax (a total rate of 8.25%) on certain North Carolina taxable income for three years. The change was estimated to affect approximately 2% of North Carolina taxpayers. In 2003, the General Assembly extended the tax rate for two years. In 2005, the General Assembly extended the tax rate for an additional two years. In 2006, the General Assembly reduced the top individual income tax rate by ¼ percent a year earlier than required by law. Thus, the upper income tax rate is 8% for tax year 2007. This rate is scheduled to be eliminated in 2008. While the Governor proposed extending the upper rate for an additional two years, the General Assembly took no legislative action on this issue during the 2007 session, effectively allowing the current 8% upper income tax bracket to expire. Beginning with the 2008 tax year, the top rate will be 7.75%.

Part II: Sales Tax Changes

Maintain Current Sales Tax Rate. – Section 31.2 of this act maintains the current sales tax rate at 4.25%. Prior to October 16, 2001, the general rate of State sales tax was 4%. Effective October 16, 2001, the general rate was raised to 4.5%. The increase was to sunset July 1, 2003. S.L. 2003-284 extended the sunset for two years to July 1, 2005. S.L. 2005-276 extended the sunset an additional two years to July 1, 2007. S.L. 2006-66 reduced the rate

[25] An individual may not claim a deduction as both a firefighter and a rescue squad worker in a single taxable year.

by ¼ cent earlier than was required under S.L. 2005-276 so that the State sales tax rate became 4.25%, effective December 1, 2006. S.L. 2007-145 extended the sunset of the remaining ¼ cent additional State sales tax rate from July 1, 2007, to August 1, 2007. This section eliminates the scheduled reduction, making the 4.25% State sales tax rate permanent. The change became effective when the Governor signed the act into law on July 31, 2007.

Amend Sales Tax Holiday. – Section 31.14 of this act makes substantive and conforming changes to enhance the sales tax holiday for school instructional material. The act does this by separating 'school instructional material' from 'school supply'. School instructional material is defined in accordance with the Streamlined Sales and Use Tax Agreement as: 'written material commonly used by a student in a course of study as a reference and to learn the subject being taught'. Practically speaking, the term encompasses primarily textbooks and workbooks. Under prior law, school instructional materials were exempt from sales tax if they had a sales price of $100 or less per item. This section expands that exemption to include any item of school instructional material with a sales price of $300 or less per item. This section became effective October 1, 2007, and applies to sales made on or after that date.

Part III: Economic Incentives

One North Carolina Fund. – The act appropriates $14 million to the One North Carolina Fund, administered by the Department of Commerce. These funds are used to offer economic development incentive grants to businesses creating new jobs in the State for infrastructure, repair and renovation, and machine or equipment purchases.

Temporary expansion of JDIG cap. – Section 13.1A of the act temporarily increases from $15 million to $25 million the maximum amount of total annual liability that may be incurred under the Job Development Investment Grant Program for 2007.

Privilege tax on software publishers' machinery and equipment. – Section 31.7 of this act subjects certain purchases of machinery and equipment by software publishing companies to a privilege tax under Article 5F of Chapter 105 of the General Statutes and exempts those purchases from sales tax. The amount of the privilege tax is 1% of the sales price of each article of machinery and equipment, limited to $80 per article. To qualify for the preferential tax rate, the following conditions must be met: (1) the purchase must be by a software publishing company in industry group 5112 of NAICS, and (2) the purchase must be of equipment or an attachment or repair part for equipment that is capitalized by the company for tax purposes under the Code, that is used by the company for research and development of tangible personal property, and that would be considered mill machinery under G.S. 105-187.51. This section became effective October 1, 2007, and applies to sales occurring on or after that date.

Enhance tax credit for research and development expenditures. – Section 31.8 of this act expands the existing tax credit for taxpayers with qualified research and development expenses. In order to be eligible for the credit, the taxpayer must satisfy the wage standard, health insurance, environmental impact, and safety and health record requirements under Article 3J. The amount of the credit is equal to a percentage of the qualifying expenses. For small business taxpayers, the applicable percentage is increased from 3% to 3.25% of the qualifying expenses. For expenses with respect to research performed in a development tier one area, the applicable percentage is increased from 3% to 3.25% of the qualifying expenses. For expenses other than those incurred by small business taxpayers or incurred for research performed in a development tier one area, the applicable percentage (i) for expenses up to $50 million is increased from 1% to 1.25% of the qualifying expenses (ii) for expenses over $50 million and up to $200 million is increased from 2% to 2.25% of the qualifying expenses, and (iii) for

expenses over $200 million is increased from 3% to 3.25% of the qualifying expenses. Finally, for North Carolina university research expenses, the applicable percentage is increased from 15% to 20% of the qualifying expenses. For each expense, only one credit is allowed; therefore, if an expense qualifies under more than one subdivision and for more than one percentage, only the higher percentage for that expense is allowed. This section is effective for taxable years beginning on or after January 1, 2007.

Modify tax credit for constructing renewable fuel facilities. – In 2004, the General Assembly created a credit for constructing renewable fuel production facilities. The credit is equal to 25% of the costs of constructing the facility. The credit may be claimed against income tax or franchise tax, is limited to 50% of the amount of tax liability against which it is claimed, and has a carryforward period of five years. That credit was set to sunset for taxable years beginning on or after January 1, 2008. In 2006, the General Assembly modified the credit by extending the sunset until 2011 and by creating an enhanced credit if the taxpayer invests at least $400 million in three separate facilities over a five-year period. As with the existing credit, the enhanced credit cannot exceed 50% of the amount of tax liability. Unlike the existing credit, the enhanced credit is equal to 35% of the costs of constructing the facility and may be claimed only against the income tax with a carryforward period of 10 years. A taxpayer may not claim both credits with respect to the same facility.

Section 31.9 of the act modifies the enhanced credit in two ways. First, the credit may be claimed against income tax or franchise tax. Second, a taxpayer who claimed the enhanced tax credit and later fails to meet the requirements of the enhanced credit may take the non-enhanced credit for constructing renewable fuel production facilities. A taxpayer who forfeits the enhanced credit must pay the additional avoided taxes and interest on the avoided taxes from the original due date of the taxes. Taxpayers have 30 days after the date the taxpayer no longer qualifies for the enhanced credit to pay the additional taxes, otherwise the total amount is subject to the penalties provided in G.S. 105-236. The modifications to the tax credit become effective for taxable years beginning on or after January 1, 2007.

Expand Sales and Use Tax Refund for Certain Aircraft Manufacturers. – Section 31.10 of this act expands the sales and use tax refund for qualifying aircraft manufacturers. This section became effective July 1, 2007, and applies to purchases made on or after that date.

The owner of an aircraft manufacturing industrial facility is allowed an annual refund of sales and use taxes paid, including those indirectly incurred, on qualified building materials and supplies, fixtures, and equipment that are installed in the construction of and become part of the real property of the facility. A written request for a refund is due within six months of the end of the State's fiscal year.

An aircraft manufacturing industrial facility is eligible for the refund if the Secretary of Commerce has certified that the owner of the facility will invest, in the construction of a facility located within the State. The taxpayer must invest at least $50 million for facilities located in development tier one areas or at least $100 million for all other facilities.

Under prior law, an aircraft manufacturing industry that qualified for the refund was limited to manufacturing or assembling complete aircraft. This section of the act expands the definition of that industry to also include the manufacturing or assembling of aircraft engines, blisks, fuselage sections, flight decks, flight deck systems or components, wings, fuselage fairings, fins, wing edges (moving, leading, and trailing), wing boxes, nose sections, tailplanes, passenger doors, nacelles, thrust reversers, landing gear, braking systems, or any combination.

Sales tax refund for research supplies. – Section 31.20 of this act, as amended by Section 14.6 of S.L. 2007-345 (Sec. 14.6, HB 714)[26] expands the authorized sales and use tax refunds contained in G.S. 105-164.14. The new refund is limited to taxpayers who (i) are engaged in analytical services within the State and (ii) increase, in comparison to their 06-07 State fiscal year expenditures, the amount of sales and use tax paid by it in this State on tangible personal property consumed or transformed in analytical service activities. The amount of the refund is 50% of the increased amount of sales and use taxes. A taxpayer must submit a written request to the Secretary of Revenue within six months after the end of the State's fiscal year, including any required documentation and information, in order to receive a refund. This section became effective when the Governor signed it into law on July 31, 2007.

Datacenter sales tax exemption. – Section 31.22 of the act substitutes a privilege tax for the sales and use tax on certain sales of purchases of machinery and equipment located and used at eligible datacenters. This section became effective October 1, 2007, and applies to sales made on or after that date.

Generally, sales of machinery and equipment are taxed at the State rate and the applicable county rate. This section imposes a privilege tax in lieu of the sales and use tax to eligible datacenters for certain purchases. For purposes of this section, an 'eligible datacenter' is a facility (1) that provides infrastructure for hosting or data processing services, (2) that has power and cooling systems that are concurrently maintainable with redundant capacity components and multiple distribution paths serving the facility's computer equipment, (3) that satisfies the wage standard and health insurance requirements of Article 3J, and (4) that the Secretary of Commerce has made a written determination that, at the time of application for the determination, $150 million in private funds has been or will be invested in improvements to real property, machinery, or equipment within five years for development tier one areas. The investment threshold is $300 million for facilities not located in a development tier one area.

Purchases of machinery and equipment by eligible datacenters are subject to the privilege tax in lieu of the sales and use tax where the machinery and equipment (1) is located and used at the datacenter, (2) is capitalized for tax purposes under the Code, and (3) is used to provide datacenter services or for the generation, transformation, transmission, distribution or management of electricity. The rate of tax is 1% of the sales price of the eligible equipment and machinery, capped at $80 per article.

A taxpayer who fails to make the level of investment required for qualification forfeits the application of the privilege tax in lieu of the sales tax and is required to pay all sales and use taxes, with interest, that would have been due on ineligible purchases. Similarly, a taxpayer who does satisfy the investment amount, but fails to use the equipment or machinery at the eligible facility forfeits the application of the privilege tax in lieu of the sales tax with respect to that particular property. A credit, in the amount of the privilege tax paid, is allowed against the sales and use taxes due following forfeiture, and interest is not computed against the amount of this offset. The past taxes and interest are due 30 days after the date of forfeiture.

Tax incentive for railroad intermodal facility. – Section 31.23 of this act, as amended by Section 14.7 of S.L. 2007-345 (Sec. 14.7, HB 714) establishes a tax credit and sales and use tax exemptions and refunds for a taxpayer who constructs or leases and puts into operation an eligible railroad intermodal facility. A railroad intermodal facility is a facility whose primary

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[26] The amendment clarifies the intent of the provision which is to provide an incentive to existing companies to increase their work performed in the State. As originally written, the provision rewarded new businesses to the detriment of existing ones.

purpose is to transfer freight between a railroad and another mode of transportation. An 'eligible' railroad intermodal facility is one whose cost of construction[27] exceeds $30 million. Fiscal Research estimates that the tax incentives provided in this section will reduce General Fund availability by $200,000 in FY07-08 and by $300,000 in FY 08-09.

Effective for taxable years beginning on or after January 1, 2007, a taxpayer who constructs or leases an eligible railroad intermodal facility in this State and places it in service during the taxable year is allowed a tax credit. The cost of construction includes the cost of constructing and equipping rail tracks to the facility that are necessary to access and support facility operations.[28] The tax credit is equal to 50% of all amounts payable by the taxpayer towards the costs of construction or under the lease. The tax credit may be taken against either the franchise tax or the income tax. The credit amount taken may not exceed 50% of the tax against which it is applied. Any unused portion of the credit may be carried forward for 10 years. The carryforwards must be claimed against the same tax. The Department of Revenue must report annually on the number of taxpayers claiming this credit, the amount of each credit claimed and the taxes against which it was applied, and the total cost of the credits claimed. The credit expires for taxable years beginning on or after January 1, 2038.

Effective for sales made on or after January 1, 2007, sales to the owner or lessee of an eligible railroad intermodal facility of intermodal cranes, hostler trucks, and locomotives located and used at the facility are exempt from State and local sales and use tax. An owner or lessee of an eligible railroad intermodal facility may also apply for an annual refund of sales and use taxes paid by it on building materials, supplies, fixtures and equipment that become a part of the real property of the railroad intermodal facility. A request for a refund of taxes paid must be submitted within six months after the end of the State's fiscal year (June 30). A refund request received after the due date is barred. Unlike the tax credit, the sales and use tax exemption and refund for an eligible railroad intermodal facility do not have an expiration date.

Part IV: Excise Taxes

University Cancer Research Fund. – Section 6.23 of the act raises the excise tax levied on tobacco products other than cigarettes from 3% to 10%, with the Secretary of Revenue remitting the additional tax to the University Cancer Research Fund (Fund). The increase in the excise tax is effective October 1, 2007, and applies to products acquired on or after the effective date and to taxes paid on or after the effective date. A wholesale or retail dealer of tobacco products other than cigarettes with an inventory of these products as of the effective date are required to file a report of the inventory within 20 days of the effective date with the Secretary and pay the additional tax on the inventory.

This Fund is a special revenue fund in the Office of the President of UNC. Allocations from the Fund are made in the discretion of the Cancer Research Fund Committee but may be used only for the purpose of cancer research under UNC Hospitals or the Lineberger Comprehensive Cancer Center. In the act, the General Assembly found that the State needed to provide at least $50 million per year to the Fund. Each July 1, this sum is transferred to the Fund as follows: (1) $8 million is transferred from the Tobacco Trust Account; (2) all revenue generated by the additional excise tax levied on tobacco products other than cigarettes; and (3) any additional

[27] S.L. 2007-345 amended the definition of 'costs of construction', as enacted by this section, to clarify that the term includes constructing and equipping rail tracks to the facility that are necessary to access and support facility operations.

[28] This clarifying language was added to the provision by Section 14.7 of S.L. 2007-345.

amount needed to raise the total amount to $50 million is appropriated from the General Fund.[29]

The Cancer Research Fund Committee is a seven-member committee with five ex officio members and two appointed members. The five standing members are (i) the President of UNC, who serves at the chair of the committee, (ii) the Director of the Lineberger Comprehensive Cancer Center, (iii) the Dean of the School of Medicine at UNC, (iv) the Dean of the School of Public Health at UNC, and (v) the Dean of the School of Pharmacy at UNC.[30] The five standing members appoint the remaining two members by majority vote. Each appointed member must hold a leadership position in a nationally prominent cancer program. A majority of the committee constitutes a quorum, and the Committee must meet at least once quarterly, with special meetings at the call of the chair or with the written request of a majority of the members.

Cap the variable wholesale component of the motor fuels tax rate for two years. – A motor fuel excise tax is imposed on all motor fuels sold, distributed, or used in the State. The rate of tax consists of a flat rate of 17.5¢ per gallon plus a variable wholesale component equal to the greater of 7% of the average wholesale price of motor fuel during a base six-month base period or 3.5¢ per gallon. In 2006, the General Assembly capped the variable wholesale component of the motor fuels tax at 12.4¢ per gallon, the wholesale rate for the period of January 1, 2006, through January 30, 2006, for a maximum possible rate of 29.9¢ per gallon.

Section 31.15 of the act extends the existing cap for two years, capping the variable wholesale component of the motor fuels tax rate at 12.4¢ per gallon for the period July 1, 2007, through June 30, 2009, for a maximum possible rate of 29.9¢ per gallon.[31] This section became effective when the Governor signed the act into law on July 31, 2007.

Part V: General State & Local Changes

State Assume Medicaid Responsibilities. – Under section 31.16 of the act, as amended by Section 14.4 of S.L. 2007-345 (Section 14.4 of HB 714), the State assumes the counties' share of the nonfederal share of Medicaid costs over a three-year period. To provide the financial resources to assume these costs, this section phases out the third one-half cent local sales tax and makes a corresponding increase in the State sales tax rate. In addition, the legislation changes the distribution of the second one-half cent local sales tax from per capita to point-of-origin. Finally, the section provides for a State hold harmless so that every county will benefit from these changes by at least $500,000 annually.

Under previous law, the State was responsible for 85% of the non-administrative, nonfederal share of Medicaid and the counties were responsible for the remainder. This act phases out the county responsibility over three years. Effective October 1, 2007, the State will assume 25% of the counties' share of the non-administrative, nonfederal share of Medicaid costs. Effective July 1, 2008, the State will assume 50% of the counties' share of the non-administrative, nonfederal share of Medicaid costs. Effective July 1, 2009, the State will assume the entire

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[29] The amount appropriated from the General Fund to the Fund for the 2007-08 fiscal year is $5.6 million, and the amount appropriated from the General Fund to the Fund for the 2008-09 fiscal year is $15.5 million.

[30] If any specified position ceases to exist, the successor position, and the person holding it, is deemed substituted.

[31] In addition to the motor fuels tax, the State also charges a motor fuel inspection fee of .25¢ per gallon. The fee increases the motor fuels tax rate from 29.9¢ to 30.15¢ per gallon.

non-administrative, nonfederal share of Medicaid costs. The counties retain responsibility for the costs associated with administering Medicaid at the county level.

To offset the additional costs assumed by the State with respect to Medicaid, the State adjusts the amount distributed from corporate income tax receipts under the Public School Building Capital Fund and gradually assumes one-half cent of local sales and use tax. The adjustment to the ADM funding formula for the Public School Building Capital Fund is for fiscal year 2007-2008 only. If the State assumes more Medicaid payments for FY 07-08 than the county would receive from ADM funding, the amount of the allocation from the Public School Building Capital Fund is reduced by 60%. If the State assumes less Medicaid payments for FY 07-08 than the county would receive from ADM funding, the amount of the allocation from the Fund is reduced by 60% of the county's Medicaid payments assumed by the State for FY 07-08.[32] Effective October 1, 2008, the State begins assuming the third one-half cent local sales and use tax. The act repeals the per capita portion (¼-cent) of the local third one-half cent sales tax, effective October 1, 2008. It increases the State sales tax rate by 0.25%, effective October 1, 2008. Effective October 1, 2009, the act repeals the remaining one-quarter cent of the third one-half-cent local sales tax rate and increases the State sales tax rate by 0.25%.

Effective October 1, 2009, the act changes the allocation of the second one-half cent local sales tax from per capita to point of collection. Beginning July 1, 2009, 1½% of the 2% local tax will be allocated on a point of collection basis and ½% will be allocated on a per capita basis.

The act includes two separate hold harmless provisions. First, counties are required to hold cities harmless with respect to the reduction in local sales and use tax revenue. Second, the State is required to make hold harmless payments to counties to ensure that each county benefits by at least $500,000 as a result of the provisions of this section. In paying this hold harmless amount, the Secretary estimates the repealed sales tax amount, the Medicaid expenditures, and the adjusted ADM payments to determine an estimated hold harmless payment for a county for a fiscal year. The State sends 90% of the estimated hold harmless payment to the county with the March distribution of the local government sales and use taxes. The remainder would be sent no later than August 15th after the Secretary determines the difference between the county's repealed sales tax amount and its hold harmless threshold for the year.

The act makes conforming changes to the transitional hold harmless for repealed reimbursement amounts and to the sales tax distribution to local governments of the State sales tax collected on telecommunications services and video programming services.

Local Option County Taxes. – Section 31.17 of this act, as amended by Section 14.5 of S.L. 2007-345 (Section 14.5 of HB 714), creates two new taxes, of which counties may choose one to levy if a majority of those voting in a referendum vote for the levy of the tax. This section became effective when the Governor signed it into law on July 31, 2007.

The first option is a land transfer tax on transfers of land within the county. The rate of tax may be up to .4% of the greater of the value of or consideration paid for the property, and the rate must be an increment of .1%. The land transfer tax is in addition to the excise stamp tax on conveyances of land, and land exempt from the stamp tax is also exempt from the land transfer tax. The tax is administered in the same manner as the stamp tax. The tax becomes

[32] In order to lessen the impact on local school administrative units, the act provides that a county must use a portion of the funds available to it, as a result of the assumption by the State of part of the county's Medicaid payments, for public school capital outlay purposes or to implement an approved local school technology plan. The amount it must use for these purposes is the difference between what it would receive from the Fund based on its ADM and the adjusted amount it actually received.

effective on the first day of the month specified in the resolution but may not be earlier than the first day of the month that is two months after the resolution is adopted. Proceeds of the transfer tax may be used for any lawful purpose, and repeal or reduction of the tax may be by resolution, effective the first day of the month but not until the end of the fiscal year. Repeal or reduction does not affect a then-existing liability or right to a refund.

As an alternative to the land transfer tax, Section 31.17 also authorizes a second option, a one-quarter cent sales and use tax. The rate of tax is .25% of the sales price of the item, in addition to all other State and local sales and use taxes, except for purchases of food exempt from tax under G.S. 105-164.13B. The adoption, levy, collection, administration, and repeal of this sales and use tax are in accordance with the first one-cent local sales and use tax (Article 39 of Chapter 105 of the General Statutes). The amount collected within the county goes solely to the county; no amount is allocated to the municipalities within the county.

Finally, this section resolves administrative concerns regarding when the combined general rate increases. Cable and satellite services, telecommunications, ancillary services, and liquor are subject to the combined general rate, all of which the State retains. During discussion on this provision, questions arose as to when the combined general rate would change relative to the adoption or levy of the quarter-cent local sales and use tax authorized by this section. Accordingly, G.S. 105-164.15A makes clear that the combined general rate change occurs for increases in authorization for local sales and use taxes on the date when local sales and use taxes become effective in the first county or group of counties to levy the authorized tax. For repeals of the authorization for local sales and use taxes, the change is effective on the effective date of the repeal. The effective date of a change in the State general rate of tax would also be the effective date for a change in the combined general rate.

Part VII: Capital Appropriations

Special Indebtedness Projects. – Section 29.13 of the act authorizes approximately $550,000,000 of special indebtedness to pay the capital facility costs of various University and State facilities over the next three fiscal years.

Land for Tomorrow and Waterfront Access and Marine Industry Fund. – Section 29.14 of the act authorizes $120,000,000 of special indebtedness to finance the costs of land acquisitions, waterfront properties, and the development of facilities for the purposes of providing and improving public and commercial waterfront access. Of this amount, $50,000,000 is allocated for land acquisitions for the expansion of the State Park System; $50,000,000 is allocated for land acquisition to conserve ecological diversity of the State; and $20,000,000 is allocated for waterfront access and the development of facilities to provide waterfront access. The Parks and Recreation Trust Fund will reimburse the General Fund for debt service on special indebtedness issued to acquire land for the State Park System and to acquire waterfront access. The Natural Heritage Trust Fund will reimburse the General Fund for debt service on special indebtedness issued to acquire land to conserve ecological diversity.[33]

SALES TAX EXEMPTION FOR BAKED GOODS.

Session Law	*Bill #*	*Sponsor*
S.L. 2007-368	**SB 1240**	**Senator Kerr**

[33] G.S. 113-77.9(b3) is amended to increase the percentage of money in the Natural Heritage Trust Fund that may be used to reimburse the General Fund for debt service from 50% to 60%.

AN ACT TO ENSURE THAT ALL BREAD SOLD AT A BAKERY THRIFT STORE IS TAXED AT THE SAME SALES TAX RATE.

OVERVIEW: This act exempts bread, rolls, and buns sold at a bakery thrift store from State sales tax.

FISCAL IMPACT: This act will have a minimal impact on State and local government sales tax revenues. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2007 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective October 1, 2007, and applies to sales made on or after that date.

ANALYSIS: The Streamlined Sales Tax Agreement (Agreement) requires member States to treat terms defined under the Agreement consistently. For items that are not defined, a State may enact entity-based exemptions, notwithstanding that the items might be included in a broader product definition under the Agreement.

Prepared food, a defined term under the Agreement, is taxed at the combined State and local sales tax rate in North Carolina irrespective of whether it is intended for home consumption. If a baked good[34] meets the definition of a prepared food, it is subject to the combined rate; if not, it is exempt from State tax and subject only to the local sales tax on food.

This act exempts bread, rolls, and buns that otherwise meet the definition of a prepared food from the State sales tax when sold at a bakery thrift store, which is defined as a retail outlet of a bakery that sells at wholesale over 90% of the items it makes and sells at the retail outlet day-old bread, rolls, and buns returned to it by retailers that acquired those items from the bakery.

INTEREST ON ILLEGALLY LEVIED EXACTIONS.

Session Law	*Bill #*	*Sponsor*
S.L. 2007-371	**SB 1152**	**Senator Hoyle**

AN ACT TO REQUIRE COUNTIES AND CITIES TO PAY INTEREST ON ILLEGALLY EXACTED TAXES, FEES, OR MONETARY CONTRIBUTIONS FOR DEVELOPMENT THAT ARE NOT SPECIFICALLY AUTHORIZED BY LAW.

OVERVIEW: This act requires cities and counties to pay 6% annual interest on any illegally exacted tax, fee, or monetary contribution for development or a development permit.

FISCAL IMPACT: No impact on State revenues. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2007 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective when signed into law by the Governor on August 19, 2007, and applies to actions filed on or after that date.

ANALYSIS: The genesis of this act was a ruling by the North Carolina Court of Appeals in the case of *Durham Land Owners Association v. County of Durham*[35] in which the Court invalidated

[34] The term 'baked goods' includes bread, rolls, buns, biscuits, bagels, croissants, pastries, donuts, danish, cakes, tortes, pies, tarts, muffins, bars, cookies, and tortillas when those goods are prepared by the retailer by mixing or combining two or more foods for sale as a single item.
[35] 177 N.C.App. disc. review denied, 629, 360 N.C. 532.

a local ordinance authorizing the assessment of school impact fees on developers for new home construction.[36] The plaintiffs, a group of developers and homebuilders, challenged the ordinance on the grounds that Durham County did not have proper enabling legislation from the General Assembly. The County argued that it had general authority to levy 'fees and commissions' to carry out duties required by law and did not need specific legislative authority to levy the impact fees. The trial court agreed with the plaintiffs and ordered that the County refund the payments, totaling approximately $8 million, with interest.

While the North Carolina Court of Appeals upheld the trial court's decision to invalidate the ordinance and refund the money collected, it reversed the award of interest. In reaching this decision, the Court examined the relevant statute and prior case law and concluded that there was no precedent for changing the 'long standing rule' that the State and its political subdivisions do not pay interest under G.S. 24-5 on judgments against it. G.S. 24-5 sets out the rate of interest and the manner in which it accrues on judgments. The statute does not specifically authorize the accrual of interest on judgments against the State or its political subdivisions. Without specific authorization, governmental immunity precludes the accrual of interest when the unit of government is engaged in a governmental function. In this case, Durham County was exercising a governmental function when it imposed a school construction fee without appropriate authority.

In response, the General Assembly passed this act granting specific statutory authority for the accrual of interest at the rate of six percent (6%) per annum on judgments entered against a city or county for the illegal exaction of a tax, fee, or monetary contribution for development or a development permit not specifically authorized by law. However, the act does not apply to the *Durham* case because the effective date makes it clear that the act applies only to actions filed on or after the effective date of August 19, 2007.

MODIFICATIONS TO PROJECT DEV. FINANCING ACT.

Session Law	*Bill #*	*Sponsor*
S.L. 2007-395	**SB 1196**	**Senator Clodfelter**

AN ACT TO MODIFY THE PROJECT DEVELOPMENT FINANCING ACT.

OVERVIEW: This act does two things:

- It allows local governments to use the proceeds of project development financing debt instruments to provide parks and recreation facilities, community college facilities, and school facilities.
- It removes the requirement that the base valuation of a development financing district be increased as the result of an increase in valuation due to revaluation.

FISCAL IMPACT: No impact. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2007 Session. Available in the Legislative Library.)*

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[36] Between 1985 and 1991, the General Assembly gave three counties and several municipalities the authority to implement impact fees. Impact fees are charged by local governments to developers who wish to construct new properties. The revenue from the impact fees are used to pay for the construction of public facilities necessitated by the development. Since 1991, the General Assembly has not given any local government new impact fee authority. In 2003, Durham became the first North Carolina county to create impact fees without a specific legislative mandate.

EFFECTIVE DATE: This act became effective when signed into law by the Governor on August 20, 2007.

ANALYSIS: In November 2004, the voters approved a constitutional amendment that has enabled counties, cities, and towns to use project development financing for the public portion of certain economic development projects within a defined territorial area. Project development financing, also known as tax increment financing, allows a local government to issue bonds secured by the incremental property tax increase generated by the development financed. This financing mechanism can be used for airports, auditoriums and arenas, hospitals, museums, parking facilities, sewer systems, storm sewers and flood control facilities, water systems, street improvements, public transportation facilities, railroads, affordable housing, land development for industrial or commercial purposes, utilities, and redevelopment. Prior to the bonds being issued, the local government must adopt a development financing plan describing the projects to be financed and how the tax proceeds will be used. The local government must also obtain approval from the Local Government Commission.

Once the district has been established and the project development financing debt instruments have been approved, the local government must notify the county tax assessor who must determine the base valuation of the district. The base valuation is the assessed value of all taxable property located in the district on the January 1 immediately preceding the effective date of the district. The base valuation may be adjusted if property is removed or added to the district. The base value may also be increased if the property values of the district increase as the result of a revaluation. Each year the tax assessor must determine the current assessed value of taxable property in the district. To the extent the current value exceeds the base value, the difference is the incremental valuation of the district. Property taxes levied on the incremental valuation of the district are placed in a separate fund and may be used to finance capital expenditures in the district, to meet principal and interest requirements on project development financing debt instruments, to repay moneys expended on debt service of project development financing debt instruments, and to establish and maintain debt service reserves.

This act makes the following changes to the project development financing act:

- It includes parks and recreation facilities, excluding stadiums, arenas, golf courses, swimming pools, wading pools, or marinas, among the purposes for which project development financing may be used. Included in this category, by reference, are the following: athletic fields, parks, playgrounds, recreation centers, shelters, permanent and temporary stands, and lighting.[37]
- It includes community college facilities[38] and school facilities[39] among the purposes for which project development financing may be used.
- It allows project development financing to be used for services and facilities authorized to be provided in a municipal service district without the creation of such a district. Under prior law, the proceeds of project development financing could be used for any service or facility authorized by G.S. 160A-536 and provided in a municipal service district. The act provides that no municipal service district needs to be created for the purpose of expending the funds. The formation of a municipal service district requires

[37] G.S. 159-48(b)(13).
[38] G.S. 159-48(c)(1).
[39] G.S. 159-48(c)(4).

substantially the same steps as are required in the creation of a development financing district and is unnecessary duplication.

- It removes the requirement to increase the base valuation of a development financing district if property values of the district as they existed on the January 1 immediately preceding the effective date of the district are increased by a revaluation. The rationale for the removal of this requirement is that the statute already requires any excess revenues be paid to the taxing entity and that the benefit, if any, to the taxing entity as the result of the adjustment is outweighed by the complicated and unclear procedure regarding how the adjustment should be made.

PROMOTE RENEWABLE ENERGY/BASELOAD GENERATION.

Session Law	*Bill #*	*Sponsor*
S.L. 2007-397	**SB 3**	**Senator Albertson**

AN ACT TO: (1) PROMOTE THE DEVELOPMENT OF RENEWABLE ENERGY AND ENERGY EFFICIENCY IN THE STATE THROUGH IMPLEMENTATION OF A RENEWABLE ENERGY AND ENERGY EFFICIENCY PORTFOLIO STANDARD (REPS), (2) ALLOW RECOVERY OF CERTAIN NONFUEL UTILITY COSTS THROUGH THE FUEL CHARGE ADJUSTMENT PROCEDURE, (3) PROVIDE FOR ONGOING REVIEW OF CONSTRUCTION COSTS AND FOR RECOVERY OF COSTS IN RATES IN A GENERAL RATE CASE, (4) ADJUST THE PUBLIC UTILITY AND ELECTRIC MEMBERSHIP CORPORATION REGULATORY FEES, (5) PROVIDE FOR THE PHASEOUT OF THE TAX ON THE SALE OF ENERGY TO NORTH CAROLINA FARMERS AND MANUFACTURERS, AND (6) ALLOW A TAX CREDIT TO CONTRIBUTORS TO 501(C)(3) ORGANIZATIONS FOR RENEWABLE ENERGY PROPERTY.

OVERVIEW: This act makes the following tax related changes. The remainder of this act does not affect North Carolina tax laws and is not discussed below.[40]

- It phases out the sales taxes paid by farmers and manufacturers for electricity, piped natural gas, and other fuels.
- It establishes a tax credit for entities that provide funds to a 501(c)(3) for renewable energy property.

FISCAL IMPACT: Sections 10 through 12 of the act, which phase out the tax on electricity, piped natural gas, and fuel used by manufacturers to operate their industries, and by farmers in their farming operations, over a four-year period, have the following fiscal impact:

FY 2007-08	$(10.0 million)
FY 2008-09	$(20.0 million)
FY 2009-10	$(30.0 million)
FY 2010-11	$(45.0 million)
FY 2011-12	$(44.0 million)

(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2007 Session. Available in the Legislative Library.)

[40] For a summary of those provisions, see Chapter 11 of the *Summaries of Substantive Ratified Legislation* publication available online and in the Legislative Library.

EFFECTIVE DATE: The sales tax changes are effective over a three-year period, beginning October 1, 2007. The tax credits become effective for taxable years beginning on or after January 1, 2008.

ANALYSIS: This act establishes Renewable Energy Portfolio Standards (REPS) for North Carolina utilities. A REPS require utilities to provide a designated amount or percentage of power from renewable energy resources as a portion of their overall provision of electricity. Iowa enacted the first REPS in 1991 and as of June 2007, REPS have been enacted by the majority of the 24 states and the District of Columbia that have adopted standards requiring electric utilities to generate electricity from renewable resources. Over half of the American public lives in a state in which a REPS is in effect. States have adopted or expanded their REPS for many reasons including: economic development benefits through the promotion of a state's renewable energy resources; potential for jobs creation; prospect of increased reliability in electricity supply; and reduction of conventional air pollutants and greenhouse gases.

Phase Out-of-State Taxes Paid by Farmers and Manufacturers on Electricity, Piped Natural Gas, and Other Fuels

Section 10 of the act phases out the current sales tax rate of 2.83%[41] on sales of electricity to manufacturing industries and manufacturing plants[42] for use in connection with their operations and to farmers when used by them for farming purposes. Effective October 1, 2007, the rate is reduced to 1.8%. Effective July 1, 2008, the rate is reduced to 1.4%. Effective July 1, 2009, the rate is reduced to .8%, and effective July 1, 2010, the sales tax on these sales is entirely eliminated.

Section 11 of the act phases out the sales tax imposed on piped natural gas[43] received by a manufacturer for use in connection with the operation of a manufacturing facility and on piped natural gas received by a farmer to be used for any farming purpose other than preparing food, heating dwellings, and other household purposes. The tax is phased out over a four-year period, beginning October 1, 2007, with end-users being exempt as of July 1, 2010.

Section 12 of the act phases out the current privilege tax rate of 1%, subject to an $80 cap, of the sales price of fuel imposed on a manufacturing industry or plant that purchases fuel to operate the industry or plant.[44] Effective October 1, 2007, the rate is reduced to .7%. Effective July 1, 2008, the rate is reduced to .5%. Effective July 1, 2009, the rate is reduced to .3%, and effective July 1, 2010, the privilege tax is entirely eliminated.

Renewable Energy Tax Credits

Current law provides a tax credit for investing in renewable energy property. However, a nonprofit corporation cannot take advantage of this credit when it invests in renewable energy property because the nonprofit organization does not owe any tax. Section 13 of this act allows

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[41] The general rate of tax on sales of electricity is 3%. Sales of electricity to an aluminum smelting facility are taxed at a rate of 1%, but that rate expires for sales made on or after October 1, 2007.

[42] In S.L. 2006-66, the tax on sales of electricity to manufacturing industries and manufacturing plants was reduced from 2.83% to 2.6%, effective July 1, 2007. This act repeals that reduction and replaces it with the 1.8% rate, as provided.

[43] The tax on piped natural gas applies uniformly to all users but is structured as a declining block that decreases as the amount of therms of piped gas consumed in a month increases. Thus, low-volume users pay a higher effective rate of tax than high-volume users.

[44] Manufacturers and farmers are exempt from sales tax on purchases of fuel.

a tax credit to a taxpayer who donates money to a tax-exempt nonprofit organization[45] for the purpose of providing funds for the organization to construct, purchase, or lease renewable energy property[46] where the nonprofit organization uses the donated funds to invest in renewable energy property. The tax credit may be taken against either the franchise tax or the income tax of the taxpayer. A taxpayer who claims this credit may not also claim the donation as a charitable contribution. Moreover, the total amount of the credit may not exceed the amount of the credit the nonprofit organization could claim under G.S. 105-129.16A if it were subject to tax, which for non-residential property, is capped at $2,500,000.[47]

The amount of the credit is equal to the taxpayer's share of the credit the nonprofit organization could claim under G.S. 105-129.16A if the nonprofit organization were subject to tax or 35% of the cost of the property placed in service. The taxpayer's share of the credit is equal to the following calculation: (taxpayer's donation/cost of the renewable energy property of the nonprofit organization placed in service that year as a result of the donation) X (the amount of the credit the nonprofit organization could claim if it were subject to tax). The credit must be taken in the year in which the property is placed in service.[48]

A nonprofit organization must keep a record of all donations it receives for renewable energy property and the amount of the donations used for this purpose. If a nonprofit organization places renewable energy property in service, the nonprofit organization must give each taxpayer who made a donation a statement setting out the amount of the credit the taxpayer qualifies for, a description of the renewable energy property placed in service, the cost of the property, the amount of the credit the nonprofit organization could claim under G.S. 105-129.16A if it were subject to tax, and the taxpayer's share of the credit allowed. If the donations made for the renewable energy property exceed the cost of the property, the nonprofit organization must prorate each taxpayer's share of the credit.

EXTEND QUALIFIED BUSINESS VENTURE TAX CREDIT.

Session Law	*Bill #*	*Sponsor*
S.L. 2007-422	**HB 1598**	**Rep. Gibson, Owens, Daughtridge, Wainwright**

AN ACT TO EXTEND THE SUNSET ON THE TAX CREDITS FOR QUALIFIED BUSINESS INVESTMENTS AND TO EXTEND THE TIME FOR FILING AN APPLICATION TO OCTOBER 15.

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[45] A tax-exempt, nonprofit organization is one that is exempt from tax under section 501(c)(3) of the Code.

[46] Renewable energy property includes biomass equipment that uses renewable biomass resources for biofuel production of ethanol, methanol, and biodiesel; anaerobic biogas production of methane utilizing agricultural and animal waste or garbage; commercial thermal or electrical generation from renewable energy crops or wood waste materials; hydroelectric generators; solar energy equipment; and wind equipment. Renewable biomass resources are organic matters produced by terrestrial and aquatic plants and animals.

[47] The maximum credit amount is less for residential property. For residential property, the following ceilings apply: $1,400/dwelling for solar energy equipment for domestic water heating; $3,500/dwelling for solar energy equipment for active space heating, combined active space and domestic hot water systems, and passive space heating; and $10,500/installation for any other renewable energy property.

[48] The installment requirements in G.S. 105-129.16A for nonresidential property do not apply to this credit.

OVERVIEW: This act extends the sunset on the tax credits for qualified business investments from January 1, 2008, to January 1, 2011. It also extends the time for which a credit application may be filed from September 15 to October 15.

FISCAL IMPACT: The total amount of all tax credits for qualified business investments may not exceed $7,000,000 a year. Demand for the credit exceeded $7,000,000 in 2006 and is expected to continue to be equal to, or greater, than the cap in future years. The fiscal impact of extending the tax credit through tax year 2010 is $7,000,000 for each of the respective fiscal years. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2007 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The extension of the application filing deadline became effective January 1, 2008, and applies to applications filed on or after that date. The remainder of the act became effective when signed into law by the Governor on August 23, 2007.

ANALYSIS: This act extends the qualified business investment tax credit through tax year 2010. The qualified business investment tax credit is allowed for an individual taxpayer who invests in a qualifying small business. A qualifying small business is one of the following:

- Qualified business venture. – A business that engages primarily in manufacturing, processing, warehousing, wholesaling, research and development, or a service-related industry.[49] Its annual gross revenues may not exceed $5,000,000.
- Qualified grantee business. – A business that has received during the current year or any of the preceding three years a grant, an investment, or other funding from a federal agency under the Small Business Innovation Research Programs. Its annual gross revenues may not exceed $1,000,000.
- Qualified licensee business. – A business that has been certified by a constituent institution of The University of North Carolina or a research university as currently performing under a licensing agreement with the institution or university for the purpose of commercializing technology developed at the institution or university.

The credit is equal to 25% of the amount invested and may not exceed $50,000 per individual in a single taxable year. If the investor is a husband and wife, the $50,000 limitation applies to the couple as one entity if the investment is made from joint funds and the stock certificate is issued in both names. However, if the couple made separate investments, as indicated by the use of separate funds and by the issuance of stock certificates in separate names, then the $50,000 limitation applies to each individual. An individual investor may also claim the allocable share of credits obtained by pass-through entities[50] of which the investor is an owner.

The credit may not be taken in the year the investment is made. Instead, the credit is taken in the year following the calendar year in which the investment was made, but only if the taxpayer

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[49] A qualified business venture does not include a real estate-related business, a business that was formed for the primary purpose of acquiring all or part of the stock or assets of one or more existing businesses, or a business that is substantially engaged in one or more of the following: providing a professional service; construction or contracting; selling or leasing at retail; the purchase, sale, or development of commercial paper, notes, other indebtedness, securities, or real property, otherwise makes investments; providing personal grooming or cosmetics services; or offering any form of entertainment, amusement, recreation, or athletic or fitness activity for which an admission or a membership is charged.

[50] Pass-through entities include limited partnerships, general partnerships, S corporations, and limited liability companies.

files an application with the Secretary of Revenue. Prior to January 1, 2008, an application for the credit had to be filed on or before April 15 of the year following the calendar year in which the investment is made. The Secretary could grant extensions of this deadline, so long as the application was filed on or before September 15. The Secretary could not accept an application for the credit filed after September 15. The act provides that the application should be filed by April 15, but may be filed on or before October 15. This change removes the requirement that a taxpayer request an extension of time to file an application if the application is filed after April 15. The date of October 15 coincides with the income tax extension date.

The amount of credit a taxpayer may claim may not exceed the taxpayer's tax liability. Any unused credit may be carried forward for the next five years. The total amount of credits allowed to all taxpayers for investments made in a calendar year may not exceed $7 million.[51] The Secretary of Revenue calculates the total amount of tax credits claimed from applications filed. If the amount exceeds the cap, then the Secretary allows a portion of the tax credits claimed by allocating the total of $7 million in tax credits in proportion to the size of the credit claimed by each taxpayer. A taxpayer forfeits the credit if the taxpayer transfers the securities within one year or the qualified business redeems the securities purchased by the taxpayer within five years after the investment was made.

The purpose of the credit is to stimulate early stage investments that help move new technologies from universities and other research laboratories to commercialization. Since 1999, investors using the North Carolina qualified business venture tax credit have claimed approximately $48 million in credits and generated more than $274 million in credit-eligible capital contributions to qualifying small companies. Demand for the credit exceeded $7 million in 2006.

QTRLY ESCROW DEPOSITS/AFFILIATED DEALERS.

Session Law	*Bill #*	*Sponsor*
S.L. 2007-435	**HB 1460**	**Representative Cole**

AN ACT TO ALLOW THE ATTORNEY GENERAL TO REQUIRE CERTAIN CIGARETTE MANUFACTURERS TO MAKE QUARTERLY ESCROW DEPOSITS, TO TREAT CERTAIN AFFILIATES OF A MANUFACTURER OF OTHER TOBACCO PRODUCTS AS IF THEY WERE THE MANUFACTURER FOR PURPOSES OF ADMINISTRATION OF THE EXCISE TAX ON OTHER TOBACCO PRODUCTS, AND TO PROVIDE THAT THE PERMISSION GRANTED TO A CIGARETTE MANUFACTURER TO BE RELIEVED OF PAYING THE CIGARETTE EXCISE TAX APPLIES TO ALL TOBACCO PRODUCTS DISTRIBUTED BY THE MANUFACTURER.

OVERVIEW: This act does two different things.

- It requires certain tobacco product manufacturers who chose not to participate in the Master Settlement Agreement (NPM) to make their escrow deposits on a quarterly basis rather than an annual basis.
- It defines the term 'integrated wholesale dealer' as a wholesale dealer who is an affiliate of a manufacturer of other tobacco products and is the only person to whom the manufacturer sells its products. The act also provides that an integrated wholesale

[51] The General Assembly increased the cap from $6 million to $7 million in 2004 (S.L. 2004-124, Part 32C).

dealer is treated like a manufacturer for purposes of allowing relief from paying the excise tax on other tobacco products (OTP).

FISCAL IMPACT: No impact. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2007 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The requirement that NPM make escrow payments quarterly became effective January 1, 2008. The remainder of the act becomes effective October 1, 2007.

ANALYSIS: This act does two different things. First, it requires certain tobacco product manufacturers who chose not to participate in the Master Settlement Agreement (NPM) to make their escrow deposits on a quarterly basis rather than an annual basis. Requiring more frequent payments from a free cash flow standpoint puts pressure on NPMs to make sure they are collecting enough revenue from their cigarette sales to be able to comply with the escrow payment obligations. Several states have begun to require NPMs to make quarterly payments to better ensure compliance with the MSA. The quarterly escrow payment obligation applies to the following NPMs:

- A NPM that has not previously established and funded a qualified escrow fund in NC.
- A NPM that has not made any escrow deposits for more than one year.
- A NPM that has failed to make a timely and complete escrow deposit in any prior calendar year.
- A NPM that has failed to pay any judgment.
- Any NPM that the Attorney General has reasonable cause to believe may not make its full required escrows deposit by April 15 of the year following the year in which the cigarette sells are made.

Second, the act defines the term 'integrated wholesale dealer' as a wholesale dealer who is an affiliate of a manufacturer of other tobacco products and is the only person to whom the manufacturer sells its products. The act also provides that an integrated wholesale dealer is treated like a manufacturer for purposes of allowing relief from paying the excise tax on other tobacco products (OTP). The excise tax on OTP is paid by the wholesale dealer or retail dealer who first acquires or otherwise handles OTP. A manufacturer who is not a retail dealer and who ships other tobacco products to either a wholesale dealer or a retail dealer may apply to the Secretary to be relieved of paying the tax. Once granted permission, a manufacturer may choose not to pay the tax, which would result in the tax being paid by the wholesale or retail dealer. This part of the act became effective October 1, 2007.

An example of an integrated wholesale dealer is Conwood Sales, which is an affiliate of Reynolds American, Inc., and one of its subsidiaries, Conwood Company. Under prior law, Conwood Sales would be required to pay the excise tax on the products it receives from Conwood Company because it is a wholesale dealer and the first company in the State to handle the products produced by its affiliate, Conwood Company. Accordingly, if Conwood Company, as the manufacturer, were granted permission by the Secretary of Revenue to be relieved of paying the excise tax on the products it produces, this permission would not apply to Conwood Sales. Under this act, Conwood Company and Conwood Sales would be considered the same entity for purposes of paying the excise tax on OTP. Therefore, if Conwood Company receives permission to be relieved of paying the excise tax on other tobacco products, then that permission applies to Conwood Sales as well because Conwood Sales is an integrated

wholesale dealer of Conwood Company. The result is that the wholesale and retail dealers who purchase products from Conwood Sales would pay the excise tax.

HISTORIC REHABILITATION TAX CREDIT.

Session Law	*Bill #*	*Sponsor*
S.L. 2007-461	**HB 1259**	**Representative Howard**

AN ACT TO REMOVE THE SUNSET ON THE PASS-THROUGH ENTITY ALLOCATION PROVISIONS OF THE HISTORIC REHABILITATION TAX CREDIT.

OVERVIEW: This act allows a pass-through entity to continue to allocate the historic rehabilitation tax credit among its owners in its discretion.

FISCAL IMPACT: Minimal impact. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2007 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The act became effective when signed into law by the Governor on August 28, 2007.

ANALYSIS: North Carolina allows an income tax credit[52] to taxpayers that qualify for the federal historic rehabilitation tax credit.[53] The amount of the credit is equal to 20% of the expenses of rehabilitating an income-producing historic structure.[54] A pass-through entity may qualify for the rehabilitation credit and pass the credit on to its owners.[55]

For most State tax credits, a pass-through entity is required to allocate the credit among its owners in the same proportion that other items, such as the federal rehabilitation credit, are allocated under the Internal Revenue Code. Under the Internal Revenue Code, tax credits are allocated among S corporation shareholders in accordance with their pro rata share of the corporation, which is determined on the basis of stock ownership,[56] and tax credits are allocated among partners in a partnership in accordance with the partnership agreement.[57]

However, in 1999, the General Assembly allowed a pass-through entity to allocate the historic tax credit for income-producing property among its owners in its discretion. The allocation of the credit allows the tax credit to be utilized more fully since it can be redistributed to North Carolina investors with State income tax liability. The provision of State law allowing this

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[52] G.S. 105-129.35. The credit may not be taken for the tax year the property is placed in service but must be taken in installments over five years after the historic structure is placed in service. Any unused portion of a credit may be carried forward for a five-year period.

[53] The federal tax credit is available for rehabilitating only income-producing historic structures. The federal credit amount is equal to 20% of the rehabilitation expenses.

[54] North Carolina also allows an income tax credit of 30% of the expenses of rehabilitating an historic structure that is not income-producing, and thus not eligible for the federal income tax credit.

[55] A pass-through entity is an entity, such as a partnership, a limited liability company, or a Subchapter S corporation, that is treated as owned by individuals or other entities under federal tax law and whose income, losses, and credits are reported by the owners on their State income tax returns.

[56] State law provides that the tax credit allowed a shareholder in a Subchapter S corporation is based on the percentage of stock held by the shareholder in the corporation. G.S. 105-131.8.

[57] State law provides that the tax credit allowed a partner is based on the partnership agreement, which must have substantial economic effect, which means that the allocation agreement must reflect the economic interest of the partners in the partnership and cannot be based solely on tax consequences. G.S. 105-269.15.

allocation would have expired for taxable years beginning on or after January 1, 2008.[58] This act repeals the sunset so that the credit may continue to be allocated among the owners of a pass-through entity in the entity's discretion. The credit itself has no sunset. Each year an allocated credit is claimed, the pass-through entity and its owners must include a statement with their tax return showing both the allocation made and the allocation that would otherwise have been required under G.S. 105-131.8 or G.S. 105-269.15. The owner's adjusted basis in the pass-through entity must be equal to at least 40% of the amount of credit allocated to the owner.[59]

AMEND COMBINED MV REGISTRATION AND PT SYSTEM.

Session Law	*Bill #*	*Sponsor*
S.L. 2007-471	**HB 1688**	**Representative Folwell**

AN ACT TO AUTHORIZE THE DIVISION OF MOTOR VEHICLES TO CREATE A LIMITED REGISTRATION PLATE, TO EXEMPT MOTOR VEHICLES REGISTERED UNDER THE INTERNATIONAL REGISTRATION PLAN FROM THE COMBINED REGISTRATION AND PROPERTY TAX SYSTEM, TO PROVIDE THAT INTEREST GENERATED BY FUNDS IN THE COMBINED MOTOR VEHICLE AND REGISTRATION ACCOUNT BE CREDITED TO THE ACCOUNT, TO AUTHORIZE THE OFFICE OF STATE BUDGET AND MANAGEMENT TO DIRECT THE TREASURER TO DISTRIBUTE THE FUNDS IN THE ACCOUNT TO IMPLEMENT THE INTEGRATED COMPUTER SYSTEM, TO DISTRIBUTE ANY REMAINING FUNDS IN THE ACCOUNT TO THE LOCAL GOVERNMENTS, AND TO MAKE TECHNICAL AND CLARIFYING CHANGES TO THE COMBINED MOTOR VEHICLE REGISTRATION RENEWAL AND PROPERTY TAX COLLECTION SYSTEM.

OVERVIEW: This act makes the following changes to the combined motor vehicle registration and property tax collection system that was created in S.L. 2005-294:

- Creates a limited registration plate designed and issued by the Division of Motor Vehicles (DMV). A licensed motor vehicle dealer will be authorized to issue this limited plate to a purchaser of a motor vehicle after the dealer submits an application for title and registration fees to the DMV. Persons buying vehicles from someone other than a dealer may also obtain the limited plate upon submitting an application for title and payment of registration fees. The limited plate may allow a purchaser of a motor vehicle up to 90 days to pay property taxes on the vehicle.
- Exempts all motor vehicles registered under the International Registration Plan from the combined motor vehicle registration renewal and property tax collection system.
- Provides that the interest generated by the funds in the Combined Motor Vehicle and Registration Account located in the Treasurer's Office shall be credited to the Account. These funds will not be transferred by the Office of State Budget and Management and appropriated by the General Assembly until the Department of Transportation and the North Carolina Association of County Commissioners reach agreement on a project plan

[58] The original provision enacted in 1999 would have expired in 2002. S.L. 2001-476 extended the provision for two years and S.L. 2003-415 extended it for four years.
[59] S.L. 2003-415. Prior to 2003, the amount of credit allocated to an owner could not exceed the owner's adjusted basis in the entity.

for an integrated computer system. Any funds remaining in the Account after the system is in operation will be distributed to the local governments on a pro rata basis.

- Makes technical and conforming changes to the combined motor vehicle registration renewal and property tax collection system.

FISCAL IMPACT:

Description	***Local Government Impact***
IT and Computer System Modifications	$794,000 costs for 2009-2010
Limited Registration Plates / Temporary Stickers	$854,545 costs for 2009-2010 $854,545 costs for 2010-2011 $854,545 costs for 2011-2012
Mailing notice of limited plate expiration date / Notice to renew	$1,860,429 costs for 2009-2010 $1,860,429 costs for 2010-2011 $1,860,429 costs for 2011-2012
Local Plate Agency Fee for Collecting Payment	No estimate available at this time
Other Costs associated with implementation of S.L. 2005-294 and HB1688	No estimate available at this time
New Positions	No estimate available at this time

The above costs will be covered through the Combined Motor Vehicle and Registration Account that local governments pay into, held within the State Treasurer's Office. These funds will not be utilized until the North Carolina Association of County Commissioners approves DMV's plan of expenses and the General Assembly appropriates the funds. This Account currently has approximately $6 million for the program. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2007 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: Unless otherwise stated in the Analysis below, this act becomes 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.

ANALYSIS: In 2005, the General Assembly enacted legislation that will combine the registration for and the property tax billing and collection of motor vehicles into a combined process beginning July 1, 2010, or earlier if a combined registration and tax collection computer system is in operation before that date.[60] Instead of the Division of Motor Vehicles (DMV) sending a statement and collecting annual registration fees on one date and the county sending a statement and collecting annual property taxes on a different date, the combined system will require one statement containing all registration fees and property taxes due on the vehicle. The fees and taxes may be paid to the DMV or a DMV agent on the same date. Until the combined system is in operation, the county in which the motor vehicle is registered will continue to assess the vehicle for property taxes on a revolving, year-round basis, and the DMV will continue to collect vehicle registration fees. The goals of the combined system are to reduce the number of taxpayer interactions with government, save money, increase the overall efficiency of both functions, and improve the property tax collection rate on motor vehicles.

[60] S.L. 2005-294, as amended by Section 31.5 of S.L. 2006-259.

The act makes several changes to the combined motor vehicle registration renewal and property tax collection system described as follows:

Creation of Limited Registration Plates

The act creates a new limited registration plate that will give motor vehicle dealers the option of collecting property taxes on a vehicle sold by them and allow the purchaser of the motor vehicle up to 90 days in some cases to pay the property taxes due on the motor vehicle. A purchaser of a motor vehicle from anyone other than a dealer will also be allowed to obtain the new limited registration plate. Under the combined system, which goes into effect July 1, 2010, or earlier if the integrated computer system is in operation before this date, property taxes on a motor vehicle are due at the time of vehicle registration or renewal of registration. The combined system will require a dealer, who is authorized to issue a 30-day temporary registration plate under G.S.20-79.1[61] to collect property taxes on a vehicle when a customer purchases a vehicle from the dealer and does not transfer his or her tag. The act makes the collection of property taxes by a dealer voluntary. Under the act, a dealer, who is authorized to issue a 30-day temporary tag under current law, must also provide a purchaser of a motor vehicle with a subsequent limited registration plate designated 'temporary', if the dealer does not want to collect the property taxes from the purchaser. After collecting an application for title and the registration fees from the purchaser, the dealer must provide the purchaser with the 30-day temporary tag and submit the title application and registration fees to the DMV or its authorized agent. The dealer must then provide the purchaser with the limited plate. The limited plate will expire on the last day of the second month following the date of the application of the limited registration plate. The Property Tax Division within the Department of Revenue must mail a notice to the purchaser indicating the date on which the limited plate will expire, that registration fees have been paid, and that the registration becomes valid for the remainder of the year upon payment of county and municipal taxes and fees due in the current year.

Exempt International Registration Plan Vehicles

The act exempts all classified motor vehicles registered under the International Registration Plan (IRP) from the combined motor vehicle registration and property tax collection system. The IRP is a registration reciprocity compact among 48 states, the District of Columbia, and 10 Canadian Provinces, and provides for the payment of license fees for vehicles based upon the total distance operated in all jurisdictions.[62] Under current law, fleet vehicles owned by public service companies are exempt from the definition of classified motor vehicles and, therefore, are exempt from the combined system. The Department of Revenue determines the assessed value of these fleet vehicles by apportioning a fair and reasonable share of the value of the company using property, business, and mileage factors, and allocating the valuations of the property among the local taxing units. Each local taxing unit then applies its tax rate to the apportioned valuation just as it does for any other type of property. Other vehicles registered under the IRP but not owned by public service companies are billed for property taxes like other classified motor vehicles. Once the combined system is in place, the valuation of IRP

[61] G.S. 20-79.1 requires a dealer, who is authorized to issue a temporary registration plate to a purchaser, to first obtain a written application for titling and collect the registration fees from the purchaser, before providing the purchaser with the temporary plate.

[62] The IRP applies to any of the following vehicles: (a) a vehicle having two axles and a gross vehicle weight in excess of 26,000 pounds, (b) a vehicle having three axles or more regardless of weight, or (c) a vehicle when the combination exceeds 26,000 pounds gross vehicle weight and the vehicle travels in two or more jurisdictions.

vehicles owned by public service companies will continue to be assessed by the Department of Revenue. All other IRP vehicles will be listed by the owner during the regular January listing period in the county in which the vehicle is located, and taxes will be due at the same time as taxes on other personal property.

Interest Credited to Combined Motor Vehicle and Registration Account

The act provides that interest generated by the funds in the Combined Motor Vehicle and Registration Account shall be credited to the Account. This Account was created within the Treasurer's Office, effective January 1, 2006, and holds funds generated by 60% of the first month's interest collected on unpaid taxes on motor vehicles registered under the current staggered system.[63] This interest accrues at the rate of 5%, and the funds generated by the interest are to be used for the purpose of developing and implementing the integrated computer system necessary to implement the combined motor vehicle registration and property tax collection system.

This portion of the act became effective when signed into law by the Governor on August 29, 2007.

Transfer of Funds in Combined Motor Vehicle and Registration Account

The 2005 legislation authorized the North Carolina Association of County Commissioners to direct the State Treasurer to distribute the funds in the Combined Motor Vehicle and Registration Account to the DMV for the purpose of developing and implementing the integrated computer system. The act gives the Office of State Budget and Management (OSBM) this authority; however, the funds in the Account may not be transferred by the OSBM and appropriated by the General Assembly until the Department of Transportation and the North Carolina Association of County Commissioners reach agreement on a project plan for the integrated system. Any funds remaining in the Account after the integrated system has been certified to be in operation must be distributed to the local governments on a pro rata basis.

This portion of the act became effective when signed into law by the Governor on August 29, 2007.

PROPERTY TAX - SCHOOL CAPITAL LEASES.

Session Law	*Bill #*	*Sponsor*
S.L. 2007-477	**HB 63**	**Rep. Yongue, Johnson, Jones, Lucas**

AN ACT TO EXCLUDE FROM PROPERTY TAX REAL AND PERSONAL PROPERTY THAT IS SUBJECT TO A CAPITAL LEASE WITH A LOCAL SCHOOL ADMINISTRATIVE UNIT.

OVERVIEW: This act excludes from property tax all real and personal property that is subject to a capital lease and used as a public school facility. The act was a recommendation of the House Select Committee on Public School Construction.

FISCAL IMPACT: This act does not impact State revenues and is expected to have no significant fiscal impact on local revenues. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2007 Session. Available in the Legislative Library.)*

[63] Under the current system, property taxes for the 12-month period that begins the first month following vehicle registration or renewal become due four months after the registration or renewal.

EFFECTIVE DATE: This act is effective for taxes imposed for taxable years beginning on or after July 1, 2007.

ANALYSIS: This act excludes from property tax all real and tangible personal property that is subject to a capital lease and is used as a public school facility.[64]

In 2006, the General Assembly expanded the financing authority of local school administrative units by allowing them to enter into capital leases for school facilities.[65] These leases may relate to an existing building or new construction. Capital leases differ from operating leases in several respects. In general, a capital lease is one that is considered to have the economic characteristics of ownership. To determine whether a lease is a capital lease or an operating lease, one must look at a number of different provisions in the lease. Under generally accepted accounting principles, a capital lease is a non-cancelable contract satisfying one or more of the following conditions:

- Legal title to the property is transferred to the lessee.
- The lease contains bargain or nominal purchase options.
- The lease term equals or exceeds 75% of the asset's useful life.
- The present value of the minimum lease payments equals or exceeds 90% of the asset's fair market value.

Because a capital lease is generally considered to have the economic characteristics of ownership, the current practice of counties has been to treat the lessee in a capital lease as the responsible party for the payment of property taxes. Therefore, in the case of a school capital lease, the local school administrative unit is considered the owner for tax purposes and the property subject to the capital lease is excluded from property taxes. Generally, property owned by a unit of local government is not subject to property tax, and a local school administrative unit is a unit of local government. This act does not affect the current practice of counties.

ENACT WASC RECOMMENDATIONS.

Session Law	*Bill #*	*Sponsor*
S.L. 2007-485	**SB 646**	**Senator Albertson**

AN ACT TO PROVIDE PROPERTY TAX RELIEF FOR WORKING WATERFRONT PROPERTY, TO ESTABLISH THE ADVISORY COMMITTEE FOR THE COORDINATION OF WATERFRONT ACCESS, TO MAKE EXPANDED PUBLIC ACCESS TO COASTAL WATERS A PRIORITY IN PLANNING STATE ROAD PROJECTS, TO INCREASE FEES FOR VESSEL TITLING, TO WAIVE PERMIT FEES FOR EMERGENCY COASTAL AREA MANAGEMENT ACT PERMITS, AND TO DIRECT A STUDY OF CONSTRUCTION AND REPAIR IN REGULATED FLOOD ZONES, AS RECOMMENDED BY THE WATERFRONT ACCESS STUDY COMMITTEE.

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[64] The most common type of tangible personal property that is subject to a capital lease by a school facility is its stadium lighting system.

[65] S.L. 2006-232, as amended by S.L. 2006-259. Prior to 2006, school boards were allowed to enter into operating leases for school facilities, but the property on which the facilities were located had to be owned in fee simple by the local unit. In addition, all construction and repairs were required to be performed under the control and direction of the local board of education.

OVERVIEW: Section 1 of the act provides property tax relief to working waterfront property by classifying the property as a special class of property to be appraised, assessed, and taxed on the basis of its value in its present use as opposed to its true value. The remainder of this act does not affect North Carolina tax laws and is not discussed below.

FISCAL IMPACT: Section 1 of the act does not impact State revenues. No estimate is available for the impact on local revenues, since there is no available data regarding the acreage or value of working waterfront property. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2007 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: Section 1 of the act is effective for taxes imposed for taxable years beginning on or after July 1, 2009.

ANALYSIS: The act classifies working waterfront property as a special class of property that must be appraised, assessed and taxed at its present use value as opposed to its true value. Working waterfront property is any of the following property that has, for the most recent three-year period, produced an average gross income of at least $1,000:

- A pier that extends into coastal fishing waters[66] and limits access to those who pay a fee.
- Real property that is adjacent to coastal fishing waters and is primarily used for a commercial fishing operation[67] or fish processing, including adjacent land that is under improvements used for one of these purposes.

Working waterfront property also includes land reasonably necessary for the convenient use of the property. In order for the land to be classified as working waterfront property, the owner must submit an application to the tax assessor of the county in which the property is located and the assessor must approve the application. A new application is not required to be submitted unless the property is transferred or the property loses its eligibility for classification as working waterfront property. Deferred taxes become due on the property when it no longer qualifies as working waterfront property. At that time the owner must pay the deferred taxes for the preceding three fiscal years. In addition, the tax on the property for the fiscal year that opens in the calendar year that the deferred taxes become due is computed as if the land had not been classified as working waterfront property. Deferred taxes are the difference between the taxes due on the property taxed at its present use value and the taxes that would be due if the property were taxed at its true value.

Since 1973, the General Assembly has established only three classifications of property that are eligible for present-use value tax treatment. Agricultural land, horticultural land, and forestland that meet certain size and ownership requirements and that are actively engaged in

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[66] 'Coastal fishing waters' are defined in G.S. 113-129 as the Atlantic Ocean; the various coastal sounds; and estuarine waters up to the dividing line between coastal fishing waters and inland fishing waters agreed upon by the Marine Fisheries Commission and the Wildlife Resources Commission.

[67] 'Commercial fishing operation' is defined in G.S. 113-168 as any activity preparatory to, during, or subsequent to the taking of any fish, the taking of which is subject to regulation by the Marine Fisheries Commission, either with the use of commercial fishing equipment or gear, or by any means if the purpose of the taking is to obtain fish for sale. It does not include (i) the taking of fish as part of a recreational fishing tournament, unless commercial fishing equipment or gear is used, (ii) the taking of fish under a Recreational Commercial Gear License, or (iii) the taking of fish as provided in G.S. 113-266 (Taking fish and wildlife for scientific purposes; permits to take in normally unauthorized manner; cultural and scientific operations).

commercial production are eligible for this property tax benefit. Agricultural land and horticultural land must also meet the following minimum income requirement: for the preceding three years: an average gross income of at least $1,000. The purpose of these classifications was to help preserve farmland by insulating it from the rising property tax values caused by competing market pressure to develop farmland for commercial and residential purposes.

REFORM TAX APPEALS.

Session Law	*Bill #*	*Sponsor*
S.L. 2007-491	**SB 242**	**Senator Clodfelter**

AN ACT TO REFORM THE PROCESS FOR ADMINISTRATIVE AND JUDICIAL REVIEW OF DISPUTED TAX MATTERS.

OVERVIEW: This act substantially revises the process for the review of disputed tax matters to provide taxpayers with the opportunity for an independent hearing outside the Department prior to paying the tax. These revisions include administrative review by the Office of Administrative Hearings, the elimination of the Tax Review Board, and the referral of tax cases to Business Court. With the elimination of the Tax Review Board, the act authorizes the Secretary of Revenue to approve a multistate corporation's request to use an alternative apportionment formula for franchise and corporate income tax purposes. It also extends by one month the due date for filing corporate income and franchise tax returns and makes various changes to the tax collection statutes.

FISCAL IMPACT: No impact.

EFFECTIVE DATE: Generally, the new procedures for disputing tax matters become effective January 1, 2008, and apply to assessments that are not final as of that date and to claims for refund pending on or filed on or after that date. The provisions relating to a federal determination are effective for taxable years beginning on or after January 1, 2007. The corporate income and franchise tax filing extension is effective for taxable years beginning on or after January 1, 2008.[68]

ANALYSIS:

Part I: Reform the Administrative and Judicial Review of Disputed Tax Matters

Prior Law

Before turning to an explanation of the new act, the following is an explanation of the prior law.[69] The prior tax appeals system was divided among assessments, refund claims for overpayments, and refund claims for the payment of an unconstitutional tax. Each type of claim involved a different procedure.

Assessments. – Upon receipt of a notice of a proposed assessment, a taxpayer could request a hearing before the Secretary of Revenue. Prior to scheduling a hearing, the Department attempted to resolve the matter informally through phone conversations, letters, and conferences. If those negotiations were unsuccessful, the case proceeded to a hearing at the Department. In practice, the Secretary did not hold the hearing. Instead, the Secretary

[68] See Part III. of the Analysis for an explanation of a technical correction that is needed.

[69] As used in this Analysis, 'prior law' refers to the law that is in effect until January 1, 2008, when S.L. 2007-491 becomes effective.

exercised the authority given in G.S. 105-260.1 and delegated the responsibility of conducting the hearing and making a decision to an Assistant Secretary of the Department, who served as the Department's hearings officer. As an Assistant Secretary of the Department, this hearings officer was located within and employed by the Department. At the hearing, a taxpayer could be represented by an attorney, an accountant, or any person who has power of attorney for the taxpayer. The rules of evidence did not apply. The hearings officer had no authority to decide constitutional issues. The hearings officer was required to issue a written decision within 90 days of the hearing. This decision was considered the Secretary's decision.

A taxpayer who was dissatisfied with the Secretary's decision had two options. One option was to obtain an administrative review of the decision by the Tax Review Board, which was a three-member board consisting of the State Treasurer, the Chair of the North Carolina Utilities Commission, and an appointee of the Governor. The Tax Review Board held a hearing, but based its review on the record established at the Department. The Tax Review Board issued a decision within 90 days after the hearing, and the decision could be appealed to superior court. Under this option, the superior court reviewed the Tax Review Board's decision based on the record created at the Department. A taxpayer did not have to pay the proposed assessment while the case was under review. The other option was to bring an action in superior court within 30 days after notification of the Secretary's hearing decision. Under this option, the action in superior court was *de novo*.

Decisions of the 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 were the same, regardless of whether the action in superior court was based on the record established at the Department or was a *de novo* action.

Refunds. – The procedure for obtaining a refund of tax paid by a taxpayer differed depending on the nature of the claim. A taxpayer challenging the constitutionality of a tax had to follow the procedure set out in G.S. 105-267, known as the 'payment under protest rule'. If the taxpayer claimed that the tax paid was incorrect or excessive, then G.S. 105-266.1 governed the refund procedure. Under both statutes, the taxpayer was required to apply to the Secretary in writing for a refund. Under G.S. 105-267, the refund request had to be made within three years after payment.[70] Under G.S. 105-266.1, the refund request had to be made within three years after the filing date of the return or within six months after payment of the tax, whichever was later.[71] At this stage, the procedure varied as follows:

1. *Payment under protest (G.S. 105-267).* – When a refund request was made, the Secretary had 90 days to issue a decision and refund the tax in accordance with the decision. If the tax was not refunded within 90 days, the taxpayer could file a civil action at any time within three years after the expiration of the 90-day period allowed for making the refund. Thus, the three-year period for requesting a refund when coupled with the period for filing an action gave a taxpayer a maximum of six years and 90 days to contest the tax. If upon trial it was determined that all or part of the tax was levied for an 'illegal or unauthorized purpose', judgment was entered for the taxpayer, and the State refunded the amount of the judgment.

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

[71]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.

2. *Refunds for overpayment (G.S. 105-266.1).* – The appeals route for overpayment claims was similar to the route for assessments. When a refund request was made, the Secretary reviewed the request and notified the taxpayer of the decision. If the refund was reduced or disallowed, the taxpayer could request a hearing. The Department was required to schedule a hearing within 90 days, unless the taxpayer and the Secretary agreed to a later date. Within 90 days of the hearing, the Secretary made a decision, notified the taxpayer, and adjusted the tax in accordance with the decision. A taxpayer aggrieved by the Secretary's decision could, within 90 days after notification of the decision, either petition for administrative review before the Tax Review Board, followed by appeal to superior court on the record, or bring a *de novo* civil action against the Secretary for recovery of the alleged overpayment. Either party could appeal to the appellate division from the judgment of the superior court.

The New Law

Effective January 1, 2008, Session Law 2007-491 repeals the current statutes governing the process for administrative and judicial review of disputed tax matters and replaces them with a new procedure. Under this act, the procedure for the review of a proposed assessment and a request for a refund are substantially the same. The key features of the new procedure are as follows:

Claims for refunds. – The prior procedure required a taxpayer who was requesting a refund either for an overpayment or for a tax paid under protest to apply to the Secretary in writing. However, the prior statutes did not provide any guidance on the format or the content of the request. In addition, the statute of limitations for requesting a refund differed depending on the nature of the claim.

Under the act, all requests for refunds are treated the same. A taxpayer may request a refund either by filing an amended return or by filing a written claim for a refund within the appropriate statute of limitations. The claim must identify the taxpayer, the type and amount of tax overpaid, the filing period to which the overpayment applies, and the basis for the claim. The statement of the basis does not limit the taxpayer from changing the basis. The act changes the statute of limitations to mirror federal law, which is the later of three years after the due date of the return or two years after payment of the tax.[72] The Department must take action on the refund claim within six months. If it does not, the inaction is considered a proposed denial of the refund claim. Under prior law, there was no time limitation on the Department of Revenue for responding to a refund claim.

Proposing assessments. – For the most part, the procedure by which the Department proposes an assessment is substantially the same under the act as under prior law. If the Department discovers that tax is due, it may propose an assessment within the statute of limitations by sending written notice to the taxpayer stating the basis for the assessment. Language has been added to provide that the statement of basis does not limit the Department from changing the basis at a later time. The statute of limitations for proposing an assessment is also the same in this act as under prior law, which is also the same as federal law.

Departmental review. – As a general matter, when a taxpayer objects to a proposed assessment or a denial of a refund claim, the administrative practice of the Department has

[72] The Department of Revenue has indicated that if a taxpayer's right to receive a refund expired under the prior six-month statute of limitations, the new two-year statute of limitations does not reopen the taxpayer's right to a refund. (See the Department of Revenue's *2007 Tax Law Changes*.)

been to work with the taxpayer in an attempt to resolve the matter informally. However, this practice has not been codified in statute until now. Senate Bill 242 sets out a review and conference procedure and establishes a specific time frame by which certain actions must occur. Codifying the procedure in this manner is designed to provide taxpayers with more guidance, more transparency, and more predictability with regard to the process.

Under the new process, a taxpayer who objects to a proposed denial of a refund or a proposed assessment may, within 45 days from the notice, file a request for review by the Department. This time limit provides the taxpayer with an additional 15 days compared to prior law.[73] If a taxpayer fails to request a review of a proposed denial of a refund or a proposed assessment, then the proposed actions of the Department become final. Once a proposed denial of a refund becomes final, the taxpayer may not file another amended return or claim for refund to obtain the denied refund. Once a proposed assessment becomes final, a taxpayer may not seek further administrative or judicial review of the assessment. However, the taxpayer may pay the tax and seek a refund. The Department is required to send the taxpayer a 'notice of collection' indicating that the assessment is final and collectible and stating the collection options available to the Department.

A taxpayer who requests a review initiates a two-step process consisting of an initial review followed by an informal conference. If the initial review results in the Department granting the refund or removing the assessment, the matter ends there. If the initial review does not resolve the dispute, the Department may request additional information from the taxpayer and must schedule a conference with the taxpayer. With regard to a refund claim, if a taxpayer does not respond to the Department's request for additional information, the Department may deny the claim and send a notice of proposed denial. If the taxpayer provides the information, then the Department has additional time to take action on the request, including a time period mutually agreed upon by the parties. The conference is intended to be an informal process in which the Department and the taxpayer attempt to resolve the matter. The taxpayer does not need to appear in person and may designate a representative to appear with the taxpayer or on the taxpayer's behalf. If the Department and the taxpayer are unable to resolve the matter at conference, the Department issues a final determination.

Final determination. – A final determination represents the Department's decision regarding a proposed denial of a refund or a proposed assessment. It must be issued within nine months after the date the taxpayer filed a request for review.[74] Once issued at the conclusion of the Departmental review process, it triggers the taxpayer's ability to seek further review. The final determination must state the basis for the determination and inform the taxpayer of the procedure for contesting it. A final determination regarding a proposed assessment must state the tax, interest, and penalties payable by the taxpayer, inform the taxpayer that the tax liability is due and collectible, unless the taxpayer contests the final determination, and explain the collection options available to the Department. This process of Departmental review, which may include a conference and concludes with the issuance of a final determination, is considered a taxpayer's 'prehearing remedy'. A taxpayer must exhaust this

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[73] The Department has indicated that taxpayers who filed timely protests of proposed assessments or denials of refunds before January 1, 2008 and that are still pending as of that date are not required to submit a new request. (See the Department of Revenue's *2007 Tax Law Changes.)*

[74] With regard to requests for review that are pending as of January 1, 2008, the Department has nine months from January 1, 2008 to conclude its review and issue a final determination. (See the Department of Revenue's *2007 Tax Law Changes.*)

prehearing remedy before seeking review of an adverse final determination by the Department.

Contested case hearing. – The act establishes OAH as the independent forum for the review of contested tax matters. Under prior law, the Department of Revenue was exempt from the contested case hearing procedures of the Administrative Procedure Act. Instead, the administrative review of a disputed tax matter was conducted by a hearings officer within the Department followed by appeal to the Tax Review Board. A taxpayer also had the option of bypassing this administrative review process by paying the tax and filing a civil action in the superior court. Under the new system, this option is eliminated. There are several reasons why allowing a taxpayer to bypass the administrative review process and proceed directly to court is not a desirable feature of a fair and efficient tax administration system. First, it is contrary to the fundamental principle of administrative law that one must exhaust his or her administrative remedy before filing suit. Second, allowing a taxpayer to use judicial resources to develop a record, when that record could be developed at a lower level, is in inefficient use of judicial resources. Third, allowing a taxpayer to bypass the Departmental review process may adversely impact the Department's ability to have its best case prepared. Finally, it encourages forum shopping. Taxpayers with the financial ability to pay the tax should not be able to seek review in a different forum than a taxpayer who does not have the financial ability to pay. For these reasons, the new process requires taxpayers to exhaust the prehearing remedy and then file a contested case with OAH before filing suit.

The contested case follows the procedure set forth in Article 3 of Chapter 150B of the North Carolina General Statutes, which is the same procedure for virtually all other agency-citizen disputes. This includes a fact-finding hearing before an administrative law judge (ALJ) who issues a decision. The ALJ decides the case based on a preponderance of the evidence, giving due regard to the demonstrated knowledge and expertise of the agency with respect to facts and inferences within the specialized knowledge of the agency. The ALJ's decision is returned to the agency for a final decision. The Department of Revenue must publish final decisions in contested tax cases in redacted form to remove identifying taxpayer information.

In 2000, the General Assembly made significant changes to the APA, which included strengthening the weight that must be given to ALJ decisions by agencies when making final decisions. Specifically, the agency must adopt each of the ALJ's findings of fact unless the finding is "clearly contrary to the preponderance of the admissible evidence giving due regard to the opportunity of the administrative law judge to evaluate the witnesses' credibility." In addition, the agency may not reject, substitute, or make new findings of fact unless it specifically states the reason for not adopting the ALJ's finding of fact and cites the evidence in the record on which it relied.

The agency must adopt the ALJ's decision unless it demonstrates that the decision is clearly contrary to the preponderance of the evidence in the admissible record. If the agency does not adopt the ALJ's decision, the agency must set forth its reasoning in light of the findings of fact and conclusions of law, including any exercise of discretion by the agency.

The act includes some special provisions for contested tax cases heard at OAH. First, it gives the Chief Administrative Law Judge general authority to simplify the procedures that apply to a contested tax case involving a taxpayer who is not represented by an attorney. It also requires an ALJ assigned to a contested tax case to make reasonable efforts to assist unrepresented taxpayers. Second, it requires the venue for all contested tax cases to be Wake County, unless the parties agree otherwise. Third, it provides that the record, the proceedings,

and the decision are confidential until the final decision is issued in the case. Fourth, it allows a law enforcement report to be admitted into evidence without the testimony of personnel from the law enforcement agency. Finally, it creates an exemption in the confidentiality statute regarding taxpayer information for purposes of complying with an order of an ALJ in a contested tax case.

Judicial review of final decision. – Article 4 of Chapter 150B of the North Carolina General Statutes authorizes a person who is aggrieved by a final decision in a contested case to seek judicial review in the Superior Court of Wake County or in the county in which the person resides by filing a petition within 30 days after being served with the decision. This act allows a taxpayer to seek judicial review of a final decision by the Department in accordance with that Article. Prior to seeking judicial review, the taxpayer is required to pay the tax, penalties, and interest due. The prior option of posting a bond in lieu of paying the tax, penalties, and interest is repealed by this act. Also, the taxpayer is limited to filing a petition in the Superior Court of Wake County, but the taxpayer may request referral to the Business Court. A taxpayer may appeal a decision of the Superior Court, which includes decisions of the Business Court, to the North Carolina Court of Appeals.

When the General Assembly amended the APA in 2000, those changes included changing the court's standard of review of final agency decisions to reflect the higher standard to which agencies are held in order to reject an ALJ's decision. If the agency rejects an ALJ's decision, the court must review the record *de novo* and make its own findings of fact and conclusions of law. The court may not give deference to any prior decision in the case, nor is it bound by the agency's findings of fact or conclusions of law.

Tax cases in Business Court. – The North Carolina Business Court is a specialized forum of the North Carolina State Court's trial division. Currently, the Business Court handles only cases that involve 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 act adds tax cases to the list of matters that may be designated as complex business cases and taken up by the Business Court. This change is designed to provide both taxpayers and the State 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.

***Civil actions and constitutional claims*. –** With some limitation, prior law allowed a taxpayer to pay a disputed tax and bring a civil action in the superior court in lieu of administrative review. Under the new law, a taxpayer is required to exhaust the administrative remedy first by seeking Departmental review and commencing a contested case hearing at OAH. All matters, except for a challenge to the constitutionality of a statute on its face, are resolved through judicial review of the record created at OAH.

Generally speaking, the constitutionality of a statute may be subject to a 'facial' or an 'as applied' challenge. With an as applied challenge, the plaintiff contends that the application of a statute to the person's particular facts and circumstances is unconstitutional. The practical effect of holding a statute unconstitutional, as applied, is to prevent its future application in a similar context, but it does not render the statute utterly inoperative. With a facial challenge, the plaintiff contends that no set of circumstances exists in which the statute may be constitutionally applied.

If the only basis for disputing a tax is that the statute imposing the tax is unconstitutional on its face, the matter may only be resolved by the judicial branch. Neither executive agencies nor OAH, which is a quasi-judicial body within the executive branch, has authority to determine

the facial validity of a statute. However, this act does not allow a taxpayer to bypass the Departmental review process or OAH altogether and proceed directly to court when the matter involves a constitutional claim. Under this act, a taxpayer is required to exhaust the administrative remedy before going to court. Therefore, constitutional claims may follow one of two paths under this act:

1. *Application of statute.* – If the claim involves a constitutional challenge to the application of a tax statute, then the taxpayer proceeds with a contested case at OAH. OAH serves as the fact-finding body and establishes the record in the case. The ALJ makes a decision regarding the application of the statute based on the facts elicited at the hearing. If the final decision is adverse to the taxpayer, the taxpayer has 30 days to file a petition with the Superior Court of Wake County seeking judicial review of the decision. The taxpayer may simultaneously file a Notice of Designation seeking designation as a mandatory complex business case to be heard in the Business Court.
2. *Facial challenge.* – If the claim involves a challenge to the facial validity of the statute, OAH would dismiss the case for lack of jurisdiction. At this point, the tax is collectible. The taxpayer may, within 30 days, seek judicial review of the dismissal. The taxpayer may also, within two years, file a new civil action. In either case, the taxpayer must pay the tax immediately upon conclusion of the case at OAH. A taxpayer who files a civil action in this circumstance may also seek designation of the case as a complex business case to be heard in the Business Court.

***Elimination of Tax Review Board.* –** The act eliminates the Tax Review Board and, by extension, the augmented Tax Review Board.[75] Under the revised review and appeals process, the role of the Tax Review Board is no longer needed because OAH is the independent arbiter of disputed tax matters, and the superior court is the forum for review of final decisions.

Report by Attorney General's Office. – The act directs the Office of the Attorney General to report on or before January 1, 2009, to the Revenue Laws Study Committee concerning the staffing needs of the Revenue Section as the result of the tax hearings being conducted at OAH.

Part II: Changes Relating to Federal Corrections

When the federal government corrects or otherwise determines the amount of an estate, a gift, or income that is subject to tax, the taxpayer must file a State return that reflects the change. This is so because the State estate, gift, and income taxes are, to varying degrees, based on amounts determined with respect to federal law. The change is referred to as a 'federal determination' or a 'federal correction'. This act makes three changes in the law relating to federal corrections, effective for taxable years beginning on or after January 1, 2007.

Limits on refunds and assessments. – The act creates a new provision with respect to claims for refund and to proposed assessments when a federal determination is involved. If a taxpayer files a return reflecting a federal determination that affects the amount of State tax payable and the general statute of limitations for requesting a refund or proposing an assessment has expired, then a request for refund or proposed assessment is limited to the adjustment in State tax payable reflecting the federal determination. In other words, filing a return reflecting a federal determination does not open up a taxpayer's return to all items on that return, but only

[75] The effect of eliminating the augmented Tax Review Board is discussed in more detail in *Part IV*. of this summary.

to those items that changed as a result of the federal determination. Similarly, a taxpayer may not request a refund for items beyond the scope of the federal determination.

Withholding tax. – In 2006, the General Assembly reduced from two years to six months the period of time in which a taxpayer must report a federal change based on a model uniform statute adopted by the Multistate Tax Commission. The model statute was intended to bring uniformity to this area among the states. Currently, there is a great deal of variety with some states requiring changes to be reported in as little as 90 days to as much as two years. The 2006 change inadvertently omitted the statute requiring employers to report federal changes to withholding tax. Section 17 of this act makes that conforming change by reducing from two years to six months the time period that an employer has to report federal changes.

Estate tax. – A taxpayer who fails to file an amended State return reflecting federal changes is subject to the general administrative penalties in G.S. 105-236 and forfeits the right to a refund due as the result of the federal changes. However, a taxpayer who fails to file an amended estate tax return reflecting federal changes is subject only to the loss of the refund. Section 6 of this act makes the federal correction statute for estate tax returns consistent with all of the other federal correction statutes by making failure to file subject to the general penalty provisions.

Part III: Extension of Corporate Income and Franchise Tax Filing Deadline

Sections 10 and 14 of the act extend by one month the due date for filing corporate income and franchise tax returns. With this change, the returns are due on the 15th day of the fourth month following the end of the corporation's tax year rather than on the 15th day of the third month. The change is effective for returns filed in 2009.[76]

Part IV: Alternative Apportionment Formula Requests

With the elimination of the augmented Tax Review Board, a new procedure is established for multistate corporations seeking an alternative apportionment method to determine their North Carolina corporate income and franchise tax liability. The new procedure applies to requests filed on or after January 1, 2008.

Under prior law, if a corporation believed that the statutory apportionment formula subjected the corporation to more tax than is reasonably attributable to its business within the State, it filed a petition with the Tax Review Board. The Tax Review Board, whose membership was augmented by the addition of the Secretary of Revenue, held a hearing, considered the evidence, and rendered a decision by majority vote. Prior to the passage of this act, North Carolina was the only state where this decision-making authority lay outside the Department. If the Tax Review Board concluded that the statutory formula subjected the corporation to more tax than is reasonably attributable to the State, it authorized allocation by an alternative method. The Tax Review Board's decision was not subject to appeal.

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[76] A corporation's franchise tax liability is paid for a given tax year in the same year in which the return is filed. Unlike franchise tax, a corporate income tax return reflects the tax due for the preceding year. However, franchise tax and corporate income tax are reported on the same form. Therefore, the due date of those returns must be the same. Questions have been raised with regard to the effective date in Senate Bill 242 for the one-month extension of franchise and corporate income tax returns. Returns filed in 2008 will be due on the 15th day of the third month following the end of the corporation's income year. Effective for taxable years beginning January 1, 2009, returns will be due on the 15th day of the fourth month. However, legislation will likely be introduced during the 2008 Regular Session to make any necessary conforming changes.

Under the new procedure, this role of the Tax Review Board is replaced by the Secretary of Revenue. Just like the prior law where the Tax Review Board's decision could not be appealed, the Secretary's decision may not be appealed either. The inability to appeal this decision is consistent with the procedure in the vast majority of other states. If the Secretary authorizes an alternative apportionment method, it applies for no more than three tax years. At the end of the authorization, the taxpayer may renew the request in the same manner as an original request.

Part V: Modifications to Collection Procedures

The Department of Revenue has various collection tools available to it to recover an assessment of tax, including the levy and sale of real and tangible personal property, the attachment and garnishment of intangible property, the filing of a certificate of liability, and the filing of a civil action. This act makes several substantive, clarifying, and technical changes to those collection statutes.

When Tax Is Collectible. – Under prior law, a tax was generally collectible when the Department issued a notice of final assessment. Under the revised review and appeals process, the Department does not issue a final assessment. Therefore, the act sets out the various conditions under which a tax becomes collectible. One of those conditions is when a taxpayer files a return showing tax due but fails to remit the tax due. Under prior law, the Department was required to issue a notice of proposed assessment and follow the procedures for the assessment to become final in order for the tax to become collectible. Under this act, the tax is collectible immediately upon the filing of the return.

The other circumstances under which the Department may collect a tax are as follows: (1) when the Department sends a notice of collection after a taxpayer does not file a timely request for review of a proposed assessment; (2) when a taxpayer and the Department agree on a settlement concerning tax due; (3) when the Department sends a notice of final determination concerning an assessment and the taxpayer does not file a petition for a contested case hearing; (4) when a final decision is issued on a proposed assessment after a contested case hearing; and (5) when OAH dismisses a petition for a contested case for lack of jurisdiction because the sole issue is the constitutionality of a statute on its face.

Garnishment Procedure. – Section 30 rewrites the garnishment statute to make clarifying changes and to more accurately reflect current practice. Under prior law, the Department was required to serve both the taxpayer and the garnishee with a notice of garnishment in accordance with Rule 4 of the North Carolina Rules of Civil Procedure. Under the revised statute, the Department need only send notice by United States mail. Under prior law, a garnishee had 10 days to respond to the notice of garnishment, either by offering a defense or remitting payment due. Under the new procedure, the garnishee has 30 days to comply or file a response. Another new feature is that the Department must send a garnishment release letter that includes identifying information, such as a Social Security number, in the notice. This change will address a concern expressed by employers who are often unable to identify when an employee has satisfied his obligation and is no longer subject to garnishment.

Certificates of Liability. – A certificate of tax liability (CTL) is similar to a civil judgment. Docketed with the clerk of superior court, it acts as a lien on real and personal property. Section 31 of the act makes the following changes:

- Clarifies that CTLs are subject to the legal rate of interest, which is 8%, and not the interest rate set by the Secretary applicable to assessments of tax. This codifies current practice.

- Authorizes the Department to file a CTL in Wake County against a nonresident to assist with collection in a foreign state.
- Provides that a CTL is a lien on both real and personal property from the date it is recorded. Under prior law, a CTL was a lien on real property from the date of docketing and a lien on personal property from the date of levy.
- Provides that the 10-year period in which the CTL is enforceable is tolled if the taxpayer waives the 10-year period. It is tolled until the end of the period extended by the waiver.

Civil Action. – Under prior law, there were two statutes authorizing the Department of Revenue, through the Attorney General's Office, to bring a civil action against a taxpayer to recover a tax debt, one of which applied only with regard to corporations. The act consolidates these two statutes through a rewrite of G.S. 105-243. The revised statute applies to all taxpayers in the same manner. The Department is no longer required to issue a civil execution against a corporation prior to bringing a civil action. Also, the action may be brought in the taxpayer's county of residence or in a court of competent jurisdiction in another state and changes the 'doing business' provision to a county in which the taxpayer has its principal place of business.

Part VI: Refunds of Land Transfer Tax

Section 24 of the act modifies the procedure for a taxpayer seeking a refund for overpayment of the excise stamp tax on conveyances, which is commonly referred to as the 'land transfer tax'. A taxpayer who wishes to request a refund must file a written request with the board of county commissioners of the county where the tax was paid. Under current law, the Secretary of Revenue reviews the board's decision. This act provides for review by the Property Tax Commission. A Property Tax Commission decision may be appealed directly to the North Carolina Court of Appeals.

Part VII: Corporate Officer Authority and Liability

Currently, the following individuals are authorized to sign a corporation's income and franchise tax returns: its president, vice-president, treasurer, assistant treasurer, secretary, or assistant secretary. Section 10 of this act, which applies to franchise tax, adds chief financial officers and deletes the secretary, the assistant secretary, and the assistant treasurer.[77] Section 34 also adds chief financial officers to the list of officers who may be held personally liable for failure to properly remit sales and use, motor fuels, and withholding taxes.

Part VIII: Class Actions Study

Section 45 of the act directs the Revenue Laws Study Committee to study whether any legislative changes should be made regarding the use and scope of class actions to challenge the constitutionality of a tax in light of the decision reached by the North Carolina Supreme Court in *Dunn v. North Carolina*. The Committee must report its findings to the 2007 General Assembly, 2008 Regular Session.

[77] Conforming changes were not made to the corresponding corporate income tax statute. Since the franchise tax return and the corporate income tax return are on the same form, the statutes need to match. This change will likely be corrected during the 2008 Regular Session.

PROPERTY TAX AND PUV CHANGES AND STUDIES.

Session Law	*Bill #*	*Sponsor*
S.L. 2007-497, as amended by S.L. 2007-484[78]	**HB 1499**	**Rep. Martin, Holliman, R. Warren, Braxton**

AN ACT TO INCREASE THE BENEFIT OF THE PROPERTY TAX HOMESTEAD EXCLUSION BY RAISING BOTH THE INCOME ELIGIBILITY LIMIT AND THE AMOUNT EXCLUDED FROM TAXATION; TO AUTHORIZE THE REVENUE LAWS STUDY COMMITTEE TO STUDY WHETHER AND HOW TO INDEX THE MINIMUM AMOUNT THAT IS EXCLUDED FROM TAX; TO CREATE A SENIOR CIRCUIT BREAKER PROPERTY TAX BENEFIT; TO MODIFY THE PRESENT-USE VALUE REQUIREMENTS FOR AGRICULTURAL LAND USED AS AN AQUATIC SPECIES FARM; AND TO AUTHORIZE THE REVENUE LAWS STUDY COMMITTEE TO STUDY VARIOUS MODIFICATIONS AND EXPANSIONS TO THE PRESENT-USE VALUE SYSTEM.

OVERVIEW: This act provides the following residential property tax relief:

- It increases the amount of the appraised value excluded from the property tax homestead exclusion from the greater of $20,000 or 50% of the appraised value of the residence to the greater of $25,000 or 50% of the appraised value of the residence.
- It increases the income eligibility limit of the property tax homestead exclusion to $25,000 and clarifies the definition of 'income' used to determine this limit.
- It creates a property tax homestead circuit breaker system that defers property taxes on certain owner-occupied homes. An owner who qualifies for both the property tax homestead exclusion and the property tax homestead circuit breaker may elect to take only one of these forms of property tax relief.

The act also provides present-use value property tax status to agricultural land that is used as an aquatic species farm.

Lastly, the act authorizes the Revenue Laws Study Committee to study the following issues:

- Whether to index the excluded appraised value limit in the property tax homestead exclusion and, if so, which index to use.
- Ways to address the inability of landowners to pay escalating property taxes while continuing to use their property for farming or other non-developmental purposes.

FISCAL IMPACT:

Description	*Local Government Impact*
Property Tax Homestead Exclusion Changes	$16.5 million loss for 2008-2009 $17.6 million loss for 2009-2010 $18.9 million loss for 2010-2011 $20.1 million loss for 2011-2012
Senior Circuit Breaker Property Tax Benefit	$7.8 million loss for 2009-2010 $7.2 million loss for 2010-2011 $6.8 million loss for 2011-2012

[78] Section 43.7T.(a) through (e) of S.L. 2007-484 made technical corrections only.

Present-Use Value Changes	No data available; however, the fiscal impact is expected to be minimal.

(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2007 Session. Available in the Legislative Library.)

EFFECTIVE DATE: Except as provided in the Analysis, the act became effective when signed into law by the Governor on August 30, 2007.

ANALYSIS: This act enhances residential property tax relief and modifies the requirements in order for agricultural land used as an aquatic species farm to qualify for present-use value property tax status. The act also authorizes the Revenue Laws Study Committee to study certain aspects of the property tax homestead exclusion and expansion of the present-use value statutes.

Part I: Residential Property Tax Relief

Property Tax Homestead Exclusion. – The property tax homestead exclusion applies to the permanent home of a North Carolina resident who (i) is at least 65 years of age or totally and permanently disabled and (ii) has income not exceeding the income eligibility limit. The amount of the appraised value of the home excluded from property tax is the greater of $20,000 or 50% of the tax value of the home.[79] The income eligibility limit was $18,000 until July 1, 2003. For taxable years beginning on or after July 1, 2003, this limit has been adjusted yearly by a cost-of-living adjustment (COLA) percentage used to increase Social Security benefits for the preceding calendar year. The 2007 income limit is $20,500. The income used to determine the income eligibility limit is a homeowner's adjusted gross income, as defined in the Internal Revenue Code, plus all other moneys received from every source other than gifts or inheritances received from a spouse, lineal ancestor, or lineal descendant.[80] For married applicants residing with their spouses, the income of both spouses is included, whether or not the property is in both names.

The act increases the amount excluded from property tax due on a permanent home from the greater of $20,000 or 50% of the tax value of the home to the greater of $25,000 or 50% of the tax value of the home. The income eligibility limit is increased to $25,000, and is indexed for taxable years beginning on or after July 1, 2009.[81] The definition of 'income' used to determine the income eligibility limit is amended by changing the starting point when determining income from adjusted gross income as defined in the Internal Revenue Code to all moneys received from every source other than gifts or inheritances received from a spouse. The amended definition of income prevents a taxpayer from reducing his or her income by net

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[79] A residence owned by husband and wife as tenants by the entirety is entitled to the full exclusion notwithstanding that only one spouse meets the age or disability requirements. If a residence is owned by two or more persons other than husband and wife, each owner who meets the eligibility requirements is entitled to the full exclusion not to exceed the owner's proportionate share of the valuation of the residence.

[80] Section 62 of the IRC defines adjusted gross income as a taxpayer's gross income (all income received from any source other than tax-free income) minus a number of deductions such as capital losses, business expenses, net operating losses, and IRA contributions.

[81] The act states that the income eligibility limit is $25,000 until July 1, 2008, and is indexed beginning on or after July 1, 2008. This is contradictory since this portion of the act is effective for taxes imposed for taxable years beginning on or after July 1, 2008. A technical correction will need to be made during the 2008 Session to clarify that the income eligibility limit is $25,000 for tax year July 1, 2008, and indexed for taxable years beginning on or after July 1, 2009.

business or other losses subtracted from income on a federal income tax return to arrive at an adjusted gross income figure. The removal of the adjusted gross income as the starting point should affect only a small percentage of taxpayers.

The changes to the property tax homestead exclusion are effective for taxes imposed for taxable years beginning on or after July 1, 2008.

Senior Circuit Breaker Property Tax Benefit. – The act creates a new class of property that qualifies for property tax relief, known as the property tax homestead circuit breaker. The relief is in the form of a deferral of property taxes on the permanent residence owned by a North Carolina resident and becomes effective for taxes imposed for taxable years beginning on or after July 1, 2009.

- Qualifications. The North Carolina resident must have owned and occupied the property located in North Carolina as a permanent residence for at least five years and must be at least 65 years of age or totally and permanently disabled. If the residence is owned and occupied by persons other than husband and wife, the benefit is not allowed unless all of the owners qualify and elect to seek the deferral. An owner qualifying for the circuit breaker property tax benefit and the property tax homestead exclusion must elect which benefit to use.

- Amount Deferred. The amount of property taxes deferred is based on the income eligibility limit of the property tax homestead exclusion. If the owner's income is less than this income eligibility limit, then the portion of property taxes imposed on the residence that exceeds 4% of the owner's income may be deferred. If the owner's income is between 100% and 150% of the income eligibility limit, then the portion of the property taxes on the residence that exceeds 5% of the owner's income may be deferred. The deferred taxes become a lien on the residence. Once a tax deferral has been granted, the county tax assessor must notify the owner each year of the accumulated sum of deferred taxes and interest.

- Disqualifying Event. If the owner transfers the residence, dies, or ceases to use the home as a permanent residence, the deferred taxes for the year in which the transfer, death, or change in use occurs plus the taxes deferred for the preceding three fiscal years become due. The deferred taxes together with interest must be paid within nine months after the disqualifying event occurs. Prepayment of all or part of deferred taxes may be made to the tax collector at any time, with partial payments applied first to accrued interest.

- Exceptions. The deferral is allowed to continue if the owner transfers the residence as part of a divorce proceeding to a spouse who qualifies for tax deferral, the owner transfers the residence to a co-owner of the residence, or the owner dies and passes his or share to a spouse or co-owner. The spouse or co-owner must use the residence as his or her permanent residence and elect to continue deferring payment of the tax. Also, the deferral continues if a qualifying owner ceases to use the residence because of a temporary absence for health reasons or because of an extended absence while confined to a rest home or nursing home, so long as the residence is unoccupied or occupied by the owner's spouse or other dependent. If the owner of a tax-deferred residence does not qualify for the deferral for reasons other than a disqualifying event or if the owner revokes an application for deferral, the owner may not defer any additional property taxes without submitting a new application. The interruption in qualification does not trigger payment of deferred taxes; however, the deferred taxes

existing at the time of the interruption will become due when there is a disqualifying event.

Part II: Present-Use Value Changes

Present-Use Value Taxation of Aquatic Species Farms. –The act establishes different production and acreage requirements that must be met in order for agricultural land used as an aquatic species farm to qualify for present-use value taxation. Under the current property tax statutes, agricultural land is one of three classifications that qualify for land taxable at its present-use value (PUV) as opposed to its market value. Agricultural land is defined as land that is a part of a farm unit that is actively engaged in the commercial production of growing of crops, plants, or animals. In order to qualify as agricultural land taxed at its PUV, the land must (i) be individually owned, (ii) consist of one or more tracts, one of which consists of at least 10 acres that are in actual production, and (iii) for at least three years prior to January 1 for the year in which the landowner is claiming PUV, produce an average gross income of at least $1,000.

The act modifies the classification of 'agricultural land' in the property tax statutes to allow different production and acreage requirements for agricultural land used as an aquatic species farm. The tract qualifies for PUV if it meets the existing $1,000 income requirement and either consists of at least five acres in actual production or produces at least 20,000 pounds of aquatic species for commercial sale annually, regardless of acreage. 'Aquatic species' is defined as any species of finfish, mollusk, crustacean, or other aquatic invertebrate, amphibian, reptile, or aquatic plant, and including but not limited to fish and fishes as defined in G.S. 113-129(7).[82]

This change is effective for taxes imposed for taxable years beginning on or after July 1, 2008.

Part III: Revenue Laws Study Committee

The act authorizes the Revenue Laws Study Committee to study the following issues:

- Whether to index the minimum excluded appraised value limit in the property tax homestead exclusion and, if so, which index to use.[83]
- Ways to address the inability of landowners to pay escalating property taxes while maintaining non-developmental uses of their land such as farming. The study may include a review of implementing tax benefits for donating perpetual easements on property to ensure continuation of non-developmental uses, extending PUV benefits to property that is used for wildlife conservation, and other ways to reduce property taxes to preserve property used for farmland and other non-developmental uses. Any findings, recommendations, or legislative proposals may be reported to the 2008 Regular Session of the 2007 General Assembly.

EXEMPTION FOR BALER TWINE FROM SALES TAX.

Session Law	*Bill #*	*Sponsor*
S.L. 2007-500	**HB 487**	**Representative Hill**

AN ACT TO EXEMPT BALER TWINE FROM THE SALES AND USE TAX

[82] G.S. 113-129(7) defines 'fish' and 'fishes' as all marine mammals, shellfish, crustaceans, and other fishes.

[83] Existing law indexes only the income eligibility limit of the homestead exclusion. (See G.S. 105-277.1(a2)).

OVERVIEW: This act exempts baler twine used by a farmer for certain statutory purposes from State and local sales and use tax.

FISCAL IMPACT: Minimal impact on the State and local government revenues. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2007 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective October 1, 2007, and applies to sales made on or after that date.

ANALYSIS: Under current law, the following items are exempt from sales and use tax if they are sold to a farmer[84] for use by the farmer in the planting, cultivating, harvesting, or curing of farm crops or in the production of dairy products, eggs, or animals:

- Commercial fertilizer
- Lime
- Land covers
- Potting soil
- Seeds
- Farm machinery; attachment and repair parts for farm machinery; lubricants applied to farm machinery.
- Horses
- Mules
- Fuel other than electricity.

The act adds baler twine to this list of items exempt from sales and use tax.

ECONOMIC DEVELOPMENT MODIFICATIONS.

Session Law	*Bill #*	*Sponsor*
S.L. 2007-515	**HB 1595**	**Rep. Gibson, Owens, Daughtridge, Wainwright**

AN ACT TO CLARIFY PROVISIONS IN THE LOCAL DEVELOPMENT ACT, TO CLARIFY URBAN PROGRESS ZONES AND AGRARIAN GROWTH ZONES, TO ALLOW MORE THAN ONE AGRARIAN GROWTH ZONE IN A COUNTY, TO CLARIFY WHEN THE LAST REPORT IS DUE FOR THE REPEALED LEE ACT CREDITS, TO MAKE TECHNICAL CHANGES CONCERNING THE TAX CREDITS FOR GROWING BUSINESSES; TO PROVIDE FOR PUBLICATION, MONITORING, AND REPORTING ON ECONOMIC DEVELOPMENT INCENTIVE CLAWBACKS; AND TO REQUIRE CLAWBACK PROVISIONS IN LOCAL ECONOMIC DEVELOPMENT AGREEMENTS.

OVERVIEW: This act does the following:

[84] A 'farmer' includes a dairy operator, poultry farmer, egg producer, livestock farmer, farmer of crops, and farmer of an aquatic species as defined by G.S. 106-758.

- It clarifies in the Local Development Act a local government's authority to acquire, construct, convey, or lease buildings for industrial or commercial use.
- It clarifies certain criteria for urban progress zones. It also expands the urban progress zones to address districts that have experienced massive layoffs.
- It allows more than one agrarian growth zone in a county.
- It requires a final Bill Lee Act report by the Department of Commerce on June 1, 2007, which is consistent with the Act's repeal.
- It clarifies the effective date for tax credits available under the new Article 3J, Tax Credits for Growing Businesses.
- It provides for publication, monitoring, and reporting on economic development incentive clawbacks.
- It requires clawback provisions in local economic development agreements.*

FISCAL IMPACT: No impact. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2007 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The act became effective when signed into law by the Governor on August 30, 2007.

ANALYSIS: The act modifies various economic development incentives.

Authority to acquire, construct, convey, or lease certain buildings. – The Local Development Act of 1925 authorizes counties and cities to undertake specific economic development activities to be funded by the levy of property taxes and by the allocation of other revenues whose use is not otherwise restricted by law. Among those activities is the acquisition, construction, conveyance, or lease of 'shell buildings', which are structures of flexible design adaptable for use by a variety of industrial or commercial businesses. In light of a concern that the term 'shell building' implies or is limited to buildings for general, nonspecific use only, Section 1 of this act eliminates that term. It clarifies that a local government may acquire, construct, convey, or lease any building for industrial or commercial use, regardless of whether the local government has a specific business entity in mind when it acquires, constructs, conveys, or leases a building.

Clarification of criteria for urban progress zones. – In 2006, the General Assembly created a new package of State tax incentives to replace the Bill Lee Act for most taxpayers. As part of that package, the new Article 3J replaced development zones with urban progress zones. Development zones were intended to be areas of high poverty within cities. Over the years it became clear that the development zones often included areas that were neither high poverty nor particularly urban. Under Article 3J, the intent is for urban progress zones to be more narrowly focused and subject to more stringent guidelines with respect to poverty.

Article 3J provides enhanced tax credits in urban progress zones. An urban progress zone is an area that meets certain conditions. One of the conditions seemed to require that the area of the zone zoned as nonresidential could not exceed 35% of the total area of the zone. However, the original intent was not to limit zones to only those areas that have less than 35% nonresidential development, but rather to restrict the size of the zone that did not meet the poverty requirements. According to the Department of Commerce, this wording made it very difficult to create a workable zone. The Department requested that the definition be revised to more accurately reflect the original intent when the act passed last year.

This act addresses the Department of Commerce's concerns by clarifying the definition of an urban progress zone. The act also expands the purpose of an urban progress zone so that it can be used to address districts that have experienced massive layoffs. As amended by this act, an urban progress zone is an area comprised of one or more contiguous census tracts, census block groups, or both, or parts thereof, in the most recent federal decennial census that meets all of the following conditions:

- All land within the zone is located in whole within the primary corporate limits of a municipality with a population of more than 10,000 according to the most recent annual population estimates certified by the State Budget Officer.
- Every census tract and census block group that composes part of the zone meets at least one of the following conditions:
    - More than twenty percent (20%) of its population is below the poverty level according to the most recent federal decennial census.
    - At least fifty percent (50%) of the area of the portion that is within the primary corporate limits of the municipality is zoned as nonresidential and the census tract or census block group is adjacent to a census tract or block group of which at least twenty percent (20%) of the population is below the poverty level. This portion of the zone cannot exceed 35% of the total area of the zone.
    - Its population has a poverty level greater than the poverty level of the population of the State, it population has a per capita income that is at least 10% below the per capita income of the State, and it has experienced a major plant closing and layoff within the past 10 years. A major plant closing and layoff has occurred if an industry has closed one or more facilities in the zone resulting in a layoff of at least 3,000 employees, so long as the number of employees laid off is greater than 7% of the population of the municipality.

Agrarian growth zone changes. – The 2006 legislation that created a new package of State tax incentives also created a new type of zone called an agrarian growth zone, which provides those areas with the enhanced tax credits provided to urban progress zones. The 2006 legislation restricted a county to one agrarian growth zone. This act removes that restriction. An agrarian growth zone must satisfy all of the following conditions:

- It must be composed of contiguous census tracts or block groups located within a single county that does not have any municipality with a population in excess of 10,000.
- Each census tract or block group in the zone must have more than 20% of its population below the poverty level.
- The area of the zone, less its smallest census tract, may not exceed 5% of the total area of the county.

Final Bill Lee Act report. – The Department of Commerce is required to make biennial reports on tax equity and the impact of the Bill Lee Act. With limited exception applicable to four specific industries, the Bill Lee Act is repealed effective for business activities that occur on or after January 1, 2007. The act requires the Department of Commerce to provide a final report on June 1, 2007. Since there are only a few specific businesses that may continue to take Bill Lee credits until 2010, an study of those credits after 2007 would not be representative of the credits' impact or equity.

Clarify effective date of Article 3J. – The repeal of the Bill Lee Act applies to 'business activities' occurring on or after January 1, 2007. The effective date of Article 3J, Tax Credits for Growing Businesses, is for 'taxable years' beginning on or after January 1, 2007. The act clarifies the effective date for Article 3J to avoid any possible gap where, for example, a business with its taxable year beginning on July 1 engaged in otherwise eligible 'business activities' after January 1, 2007.

Clawback provisions. – The act requires the Department of Commerce to publish, monitor, and report on economic development incentive clawbacks. Specifically, it must catalog all clawbacks in the State and federal programs it administers, including a description of each clawback, the program to which it applies, and a citation to its source. The report must be published and updated every six months.

The act also requires economic development agreements entered into between a local government and a private enterprise to contain clawback provisions allowing the local government to recapture amounts appropriated or expended if certain events occur. These events must be specified in the agreement and would include the creation of fewer jobs, the investing of less capital, or the failure to maintain operations at a specified level.

MOTOR FUEL TAX EXEMPTION FOR BIODIESEL.

Session Law	*Bill #*	*Sponsor*
S.L. 2007-524	**SB 1272**	**Senator Snow**

AN ACT TO EXEMPT BIODIESEL THAT IS PRODUCED BY AN INDIVIDUAL FOR PERSONAL USE IN A PRIVATE PASSENGER VEHICLE FROM THE MOTOR FUEL EXCISE TAX.

OVERVIEW: This act does two things:

- It exempts biodiesel that is produced by an individual for use in a private passenger vehicle from the excise tax on motor fuel.
- It directs a study of transportation funding by the Revenue Laws Study Committee and the Joint Legislative Transportation Oversight Committee.

FISCAL IMPACT: Minimal impact. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2007 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The motor fuel tax exemption became effective October 1, 2007. The study authorization became effective when the bill was signed into law by the Governor on August 31, 2007.

ANALYSIS: A motor fuel excise tax is imposed on all motor fuels sold, distributed, or used in the State. The rate of tax consists of a flat rate of 17.5¢ per gallon plus a variable wholesale component equal to the greater of 7% of the average wholesale price of motor fuel during a base six-month base period or 3.5¢ per gallon. The wholesale component of the motor fuels tax rate is capped at 12.4¢ per gallon for the period July 1, 2007, through June 30, 2009.

The following are exempted from the excise tax:

- Motor fuel in transport, if the fuel is transported by a licensed distributor or licensed exporter and the supplier of the fuel collects a tax on the fuel at the rate of the motor fuel's destination state.

- Motor fuel sold to the State, the federal government, a county, or a municipality for use by the unit of government.
- Motor fuel sold to local boards of education, charter schools, and community colleges for use by the schools.
- Diesel, in the form of kerosene, when sold to an airport.

The act creates an additional exemption for biodiesel that is produced by an individual for use in a private passenger vehicle that is registered in the individual's name. Biodiesel is any fuel or mixture of fuels derived in whole or in part from agricultural products or animal fats or wastes from these products or fats.

The act also directs the Revenue Laws Study Committee and the Joint Legislative Transportation Oversight Committee to study the issue of providing adequate funding for transportation infrastructure development and improvement. The Committees must report on this issue, including any recommendations or legislative proposals, to the 2008 Regular Session of the 2007 General Assembly.

REVENUE LAWS & MOTOR FUELS TAX TECH. CHANGES.

Session Law	*Bill #*	*Sponsor*
S.L. 2007-527	**SB 540**	**Senator Hartsell**

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

OVERVIEW: This act makes technical, clarifying, and administrative changes to the revenue laws, the motor fuels tax laws, and related statutes. These changes were a recommendation of the Revenue Laws Study Committee.

FISCAL IMPACT: No impact. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2007 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: Except as otherwise specified, this act became effective when signed into law by the Governor on August 31, 2007.

ANALYSIS:

Part I: Technical Changes

Section	Explanation
1	Deletes reference to a repealed statute.
5	Substitutes the defined term 'apportionable' for the term 'business'.
7	Substitutes the defined term 'business property' for term 'machinery and equipment'. (See additional explanation for this section in *Part II: Clarifying Changes*).
8	Substitutes the appropriate reference 'out of', for the prior reference 'to'.
19	Substitutes the correct statutory reference.
20	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.
23	Corrects a statutory reference.
27	Corrects a statutory reference.
30	Repeals an obsolete statute. The statute was enacted to facilitate a transition from the sales tax imposed on the gross receipts of motor vehicle leases prior to 1989 and the highway use tax.
32	Repeals an obsolete statute. These reimbursements were repealed in 2001 as part of the agreement on the third one-half cent local option sales tax.
36	Removes an unnecessary citation that is in the statute due to redlining errors.
37	Inserts the correct corporate name of the North Carolina State Art Society, Incorporated.
42	Corrects a statutory reference.

Part II: Clarifying Changes

2	Clarifies the term 'nonprofit arts organization' in the area of exemptions from the gross receipts tax on amusements.
3	Clarifies the duration of an arts festival and a community festival, for purposes of the exemption from the gross receipts tax on amusements. Under current law, the festival may not last more than seven days. This provision clarifies that the festival may not last more than seven *consecutive* days.
4	Clarifies that the allocation of tax proceeds from the excise tax on fortified wine to the NC Wine and Grape Growers Council occurs before the revenues are distributed to counties and cities in which the retail sale of alcoholic beverages are authorized to be sold.
6-7	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.
10	Adds ancillary services to items for which the sales tax exemption for State agencies does not apply, in order to conform to the changes made in S.L. 2006-33. S.L. 2006-33 separated ancillary services from telecommunications services to conform to the Streamlined Sales Tax Agreement. The change does not alter the taxation of these services.
11	Clarifies the dollar threshold for filing monthly sales tax returns.
12	Clarifies that the payment of use tax on purchases of boats and airplanes is not made on the use tax line of the income tax return. The payment of use tax on these items is due by the 20th day of the month following the purchase. Boats and aircraft are registered, and the Department examines information on registration to verify that use tax has been paid.
13	Clarifies that the 1% privilege tax on the purchase of equipment by a research and development company applies to equipment that would be considered mill machinery parts and accessories as well as mill machinery itself. The tax was intended to correspond to the property used by manufacturers for research and development. This section became effective July 1, 2007, which is the date that the 1% privilege tax began to apply to equipment purchased by a research and development company. Prior to this date, the equipment was subject to the State and local sales tax.

14	Exempts State agencies from the privilege tax imposed on mill machinery. The Department has interpreted the sales tax exemption for State agencies to also apply to this tax since the tax was established when these products were exempted from the sales tax in January 2006 to conform with the Streamlined Sales Tax Agreement. Under the Agreement, the State must have uniform rates. Rather than increase the tax rate on these items, they were exempt from sales tax and subject to this new privilege tax. The Department of Correction industries constitute manufacturing plants and thus purchase equipment subject to this tax.
22	Rewrites G.S. 105-330.10 to incorporate changes made in S.L. 2006-30.

Part III: Administrative Changes

9	Alters the documentation process for the credit for recycling oyster shells to reflect the current Department of Revenue practice. DENR maintains the information for the Department so that this general requirement is not necessary.
21	Conforms the date a local occupancy tax return and tax is due to the date that the sales and use tax is due. This section became effective January 1, 2008.
24	Conforms the effective date for a 2006 change to the confidentiality provisions to administrative practices.
25	Repeals the sunset of the highway use tax provisions contained in the 1989 session law. When the highway use tax was enacted, it was believed the highway projects could be completed in 13 years. It has been 18 years. The 1989 session law would repeal the highway use tax, the Transportation Oversight Committee, and various motor vehicle fees when contracts for all projects specified in Article 14 of Chapter 136 have been let and sufficient revenue has been accumulated to pay the contracts. The various fees have been amended several times since 1989. Based upon this sunset language, the fees would revert to their pre-1989 amounts at some undetermined point in the future. At this point, the sunset creates a 'trap for the unwary'.
26	Makes a change in the reporting requirements for the State Ports Tax credit. Based upon conversations with the Tax Research Division, the change will better enable it to report information to the General Assembly for purposes of determining the credit's effectiveness. The report language was added in S.L. 2005-429.
28	Allows local governments to correct errors in their certification of cable television revenues submitted to the Department of Revenue. The certification of the amount of cable franchise tax imposed had to be made by March 15, 2007. Many local governments are in the process of auditing their cable franchise taxes. As a result of those audits, many are discovering errors in their certifications. This provision allows local governments to submit a new certification on or before April 1, 2008. This provision has been requested by the League of Municipalities and agreed upon by the Department of Revenue.

31	Conforms the provisions for making an electronic funds transfer to the changes made in S.L. 2006-66. Last session, the General Assembly replaced the semimonthly sales tax payment for franchise tax and sales tax with a single monthly payment and a prepayment of the next month's liability due on the same day as the monthly payment. The change was made at the request of several large retailers in the Streamlined Sales Tax Project.
33-35	Makes two changes to the tax secrecy provisions at the request of the Tax Research Division of the Department of Revenue. Section 33 allows the Division to share information with other governmental units outside this State for the purpose of statistical reports and revenue estimates. Section 34 allows the Department of Revenue to share information with the Joint Operations Center for National Fuel Tax Compliance (JOC) to better enable the Department to enforce motor fuel tax laws and identify motor fuel tax evasion. The JOC is a partnership of dedicated federal and state fuel tax administration resources. Its membership consists of the Internal Revenue Service, the Federal Highway Administration, and state agencies that are signatories to the Memorandum of Understanding executed to form this organization. The founding membership of the JOC is the IRS, the FHWA, the California Board of Equalization, the NC Department of Revenue, and the Texas Comptroller of Public Accounts. The mission of the JOC is to facilitate state and federal motor fuel tax compliance activities, foster interagency and multi-national cooperation, and provide strategic analyses of domestic and foreign motor fuel distribution trends and patterns. It will work toward these goals through the use of technology to collect, analyze, and share information. Section 35 allows the Division to provide information needed by the Fiscal Research Division of the General Assembly to determine the fiscal impact of proposed legislation. Sometimes, if the fiscal effects of legislation apply only to a limited number of taxpayers, the Division is unable to share the information with Fiscal Research because to do so may, by virtue of the small taxpayer pool, indicate the tax liability of a particular group of taxpayers. The Division would continue to be required to remove any identifying information from the data shared.
39	Repeals the statute that authorizes real estate certificates of participation. RECOP indebtedness is a form of special indebtedness that is intended to be structured so that the principal and a portion of the interest are not paid in installments over the term of the debt. That portion of the interest compounds and is payable, along with the principal, only at maturity. The provision was enacted in 2004. The 2004 legislation directed the State Treasurer to conduct a study of RECOP indebtedness and to report to the Joint Legislative Commission on Governmental Operations by February 1, 2005. The Treasurer's Office reported that it did not recommend the State using this form of indebtedness.
40	Repeals the Article creating the Life Sciences Revenue Bond Authority. The Authority was created in 2003. The purpose of the Authority was to determine the best way to establish a credit enhancement program for construction of infrastructure for life sciences manufacturing facilities. The Authority is not functioning. Proponents in the life sciences area agree that the Authority is not needed at this time.

43	Inserts Swain County into the uniform occupancy tax provisions. S.L. 2007-23 amended Swain County's occupancy tax statutes to conform to the uniform law, but it failed to include the county in the list of counties for which the uniform law is applicable.

Part IV: Motor Fuel Tax Changes

15	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.
16	Provides that a civil penalty imposed under the motor fuel statutes 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. This section eliminates the need for similar conforming changes in the future.
17	Provides that a fuel alcohol provider and a biodiesel provider need only post a bond to receive a license as a supplier[85] 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 $500,000. 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 becomes effective October 1, 2007.
18	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.[86] 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. This section became effective when signed into law by the Governor on August 31, 2007, and applies to penalties assessed on or after that date and to refund requests that have not been finally determined as of that date.
38	Repeals a conflicting subdivision. This subdivision imposes the excise tax on motor fuel that is fuel alcohol or biodiesel when it is sold for use. However,

[85] 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)

[86] The General Assembly established this defense in 2005. (S.L. 2005-435.)

	these fuels are included in the definitions of gasoline and diesel and should be taxed at the same point in the distribution chain as gasoline and diesel. Current law conflicts as to the point at which these fuels should be taxed. The repeal of this subdivision clarifies that they will be taxed at the terminal rack or at importation. This section became effective January 1, 2008.
41	Corrects an unintended consequence of a motor vehicle law change. S.L. 2007-194 exempted certain trucks from vehicle registration requirements. In so doing, it also exempted them from the requirement that they use tax-paid fuel and from the penalty and enforcement of the motor fuel tax laws. This section provides that although the vehicles do not have to be registered, they still must abide by the motor fuel tax laws.

SOLID WASTE MANAGEMENT ACT OF 2007.

Session Law	*Bill #*	*Sponsor*
S.L. 2007-550, as amended by S.L. 2007-543	**SB 1492, as amended by SB 6**	**Senator Clodfelter**

AN ACT TO: (1) TO REPEAL THE EXEMPTION FOR SANITARY LANDFILLS OPERATED BY LOCAL GOVERNMENTS FROM THE REQUIREMENTS FOR ENVIRONMENTAL IMPACT STATEMENTS UNDER THE NORTH CAROLINA ENVIRONMENTAL POLICY ACT OF 1971; (2) CLARIFY THE CIRCUMSTANCES UNDER WHICH AN APPLICATION FOR A SOLID WASTE MANAGEMENT PERMIT MAY BE DENIED; (3) PROVIDE THAT SOLID WASTE MANAGEMENT PERMITS ARE NOT TRANSFERABLE WITHOUT THE APPROVAL OF THE DEPARTMENT OF ENVIRONMENT AND NATURAL RESOURCES; (4) INCREASE THE PENALTIES THAT MAY BE IMPOSED FOR SOLID WASTE VIOLATIONS; (5) REQUIRE THAT AN APPLICANT FOR A PERMIT AND A PERMIT HOLDER ESTABLISH FINANCIAL RESPONSIBILITY TO ENSURE THE AVAILABILITY OF SUFFICIENT FUNDS FOR PROPER DESIGN, CONSTRUCTION, OPERATION, MAINTENANCE, CLOSURE, AND POST-CLOSURE MONITORING AND MAINTENANCE OF A SOLID WASTE MANAGEMENT FACILITY; (6) CLARIFY AND EXPAND THE SCOPE OF ENVIRONMENTAL COMPLIANCE REVIEW REQUIREMENTS; (7) CLARIFY THAT A PARENT, SUBSIDIARY, OR OTHER AFFILIATE OF THE APPLICANT OR PARENT, INCLUDING ANY BUSINESS ENTITY OR JOINT VENTURER WITH A DIRECT OR INDIRECT INTEREST IN THE APPLICANT IS SUBJECT TO FINANCIAL RESPONSIBILITY AND ENVIRONMENTAL COMPLIANCE REVIEW; (8) PROVIDE FOR SITING OF COMBUSTION PRODUCTS LANDFILLS IN AREAS THAT HAVE BEEN FORMERLY USED FOR THE STORAGE OR DISPOSAL OF COMBUSTION PRODUCTS FROM COAL-FIRED GENERATING UNITS AT THE SAME FACILITY THAT GENERATED THE COMBUSTION PRODUCTS, AND TECHNICAL REQUIREMENTS FOR THESE LANDFILLS; (9) AUTHORIZE UNITS OF LOCAL GOVERNMENT TO HIRE LANDFILL LIAISONS; (10) DIRECT THE DEPARTMENT OF ENVIRONMENT AND NATURAL RESOURCES TO DEVELOP A PROPOSED RECYCLING PROGRAM FOR FLUORESCENT LAMPS; (11) DIRECT THE ENVIRONMENTAL REVIEW COMMISSION TO STUDY ISSUES RELATED TO THE FRANCHISE OF SOLID WASTE MANAGEMENT FACILITIES BY UNITS OF LOCAL GOVERNMENT, TRANSPORTATION OF SOLID WASTE BY RAIL AND BARGE, AND SITING AND TECHNICAL STANDARDS FOR SOLID WASTE MANAGEMENT FACILITIES; AND (12) MAKE RELATED CLARIFYING, CONFORMING, AND TECHNICAL CHANGES.

OVERVIEW: Section 14 of the act establishes a solid waste disposal tax to help offset the cost of the assessment and remediation of pre-1983 landfills and to provide additional resources for solid waste management programs and services. The remainder of this act does not affect North Carolina tax laws and is not discussed below.[87]

FISCAL IMPACT: The new solid waste disposal tax of $2.00 per ton is estimated to generate $25 million annually. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2007 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This tax becomes effective July 1, 2008.

ANALYSIS: Prior to 1983, landfills were not regulated. There exist more than 700 pre-1983 landfills in need of assessment and remediation. Among other things, this act establishes a solid waste disposal tax of $2.00 per ton of waste to be imposed on the disposal of municipal solid waste in landfills in the State and on the transfer of municipal solid waste for disposal outside the State. As amended by S.L. 2007-543, the act allocates the tax proceeds as follows:

- 50% to the Inactive Hazardous Sites Cleanup Fund for the assessment and remediation of pre-1983 landfills.
- 18.75% to cities in the State on a per capita basis to be used solely for solid waste management programs and services.
- 18.75% to counties in the State on a per capita basis to be used solely for solid waste management programs and services. Persons who reside in a city are not counted in the population of the county or counties in which the city is located.
- 12.5% to State agencies and units of local government to initiate or enhance local recycling programs and to provide for the management of difficult to manage solid waste, including abandoned mobile homes and household hazardous waste.

[87] For a summary of those provisions, see Chapter 11 of the *Summaries of Substantive Ratified Legislation* publication available online and in the Legislative Library.

2006

S CORP INCOME TAX ADJUSTMENTS.

Session Law	*Bill #*	*Sponsor*
S.L. 2006-17	**HB 1898**	**Representative Wilkins**

AN ACT TO MAKE CORPORATE INCOME TAX ADJUSTMENTS INAPPLICABLE TO S CORPORATIONS.

OVERVIEW: This act, which was a recommendation of the Revenue Laws Study Committee, provides that an individual's pro rata share of income from an S Corporation is subject only to individual income tax adjustments, rather than being subject to both individual and corporate income tax adjustments. The act also preserves an addition to federal taxable income for a shareholder's share of the built-in gains tax paid by an S Corporation at the federal level for purposes of determining State taxable income, since North Carolina does not assess a built-in gains tax.

FISCAL IMPACT: Minimal impact.
(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2006 Session. Available in the Legislative Library.)

EFFECTIVE DATE: This act is effective for taxable years beginning on or after January 1, 2006.

ANALYSIS: The act provides that an individual's pro rata share of income from an S Corporation is subject only to individual income tax adjustments, rather than being subject to both individual and corporate income tax adjustments. Prior to this act, an individual's pro rata share of S Corporation income attributable to North Carolina was subject to corporate income tax adjustments, while S Corporation income not attributable to North Carolina was subject to individual income tax adjustments. This change, which was recommended to the Revenue Laws Study Committee by the Department of Revenue, will provide consistency in the tax treatment of S Corporations since S Corporation income flows through to its shareholders who are required to be individuals or trusts and who are taxed at the individual level as opposed to the corporate level. The change also simplifies tax form preparation. Section 3 of the act, however, preserves an addition to federal taxable income for a shareholder's share of the built-in gains tax paid by the corporation at the federal level for purposes of determining State taxable income. This add-back to federal taxable income is required under current law.

The 'built-in gains tax' in Section 1374 of the Internal Revenue Code imposes a corporate-level tax on S Corporations that dispose of assets that appreciated in value during the years when the corporation was a C Corporation. The built-in gains tax applies only to assets that are disposed of within 10 years of the date on which S Corporation status is chosen. The shareholders of the S Corporation are also taxed on the gains. To provide some measure of relief from double taxation, each shareholder's share of income from the S Corporation is reduced by the shareholder's proportionate share of the built-in gains tax paid by the S Corporation.[1] The built-in gains tax is designed to prevent corporations that have unrecognized

[1] IRC Section 1366(f)(2).

gain on assets during the years the corporation is a C Corporation from converting to S status and then distributing the assets tax free.

North Carolina does not assess a built-in gains tax. Therefore, there is no double taxation at the State level and no reason to allow the deduction for the shareholder's share of the built-in gains tax. Under existing law, there is a corporate income tax provision requiring an add-back for the built-in gains tax deduction. Since this act subjects S Corporations to individual income tax adjustments only, the act modifies existing law to require an S Corporation shareholder to add to taxable income the amount by which the shareholder's share of the S Corporation's income was reduced for federal purposes by the amount of the built-in gains tax imposed on the S Corporation.

An S Corporation is a corporation that has elected to have the corporation's income pass through to the shareholders. Thus, the business profits are taxed at individual tax rates. An S Corporation election allows the shareholders to preserve the benefit of limited liability for the corporate form while at the same time being treated as partners for federal income tax purposes. The S Corporation itself does not pay any income tax, but an S Corporation is required to file an informational return with the IRS, similar to a partnership tax return, to inform the IRS of each shareholder's ownership interest in the S Corporation. To be eligible for S Corporation status, a corporation must meet all of the following requirements:

- The corporation may have no more than 75 shareholders.
- The corporation may have only one class of stock, although different voting rights among shareholders are allowed.
- All shareholders must be individuals or trusts.
- The corporation must be formed in the United States.
- No shareholder may be a non-resident alien.
- The corporation may not be an insurance company or a domestic international sales corporation.

A C Corporation, on the other hand, assumes a separate legal and tax life distinct from its shareholders. It pays taxes at its own corporate income tax rates and files its own corporate tax forms each year. C Corporations may choose to retain their profits and earnings as part of their operating capital, or they may choose to distribute some or all of their profits and earnings as dividends paid to shareholders. Dividends paid to shareholders are essentially taxed twice, once at the corporate level and again at the individual level.

As previously noted, C Corporations cannot be shareholders of an S Corporation. All S Corporation shareholders must be individuals or trusts and are taxed at the individual income tax rates.

IRC UPDATE.

Session Law	*Bill #*	*Sponsor*
S.L. 2006-18	**HB 1892**	**Rep. Wainwright; Luebke; Carney; Wilkins; (Primary Sponsors)**

AN ACT TO UPDATE THE REFERENCE TO THE INTERNAL REVENUE CODE USED IN DEFINING AND DETERMINING CERTAIN STATE TAX PROVISIONS AND TO MAKE OTHER CHANGES TO MORE CLOSELY CONFORM TO FEDERAL TAX LAW.

OVERVIEW: This act, which was a recommendation of the Revenue Laws Study Committee, does the following:

- Updates the reference to the Internal Revenue Code used in defining and determining certain State tax provisions.
- Shortens the time span which a taxpayer has to file an amended estate, income, or gift tax return when the federal government corrects or otherwise determines the amount on which the tax is based.
- Conforms the filing date for income tax returns for a nonresident alien to the federal dates.
- Conforms the amounts for the credit for child care and certain employment-related expenses to the amounts allowed for the corresponding federal credits.

FISCAL IMPACT: Annual revenue loss is estimated to be $5.1 million in 2006-07 and 2007-08.
(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2006 Session. Available in the Legislative Library.)

EFFECTIVE DATES: The update to the reference to the Internal Revenue Code became effective when signed into law by the Governor on June 21, 2006. The part of the act concerning federal determinations became effective July 1, 2006, and applies to federal determinations made on or after that date. The parts of the act conforming the filing date for tax returns for nonresident aliens and the credit amounts for child care are effective for taxable years beginning on or after January 1, 2006.

ANALYSIS: The act makes the following changes to the revenue laws.

Federal Determinations

This act reduced the period of time in which a taxpayer must report a federal change from two years to six months. When the federal government corrects or otherwise determines the amount of an estate, gift, or income that is subject to tax, the taxpayer must file a State return that reflects that change. This is so because the State estate, gift, and income taxes are, to varying degrees, based on amounts determined with respect to federal law. The Multistate Tax Commission has adopted a model uniform statute for reporting federal changes. That model uniform statute requires a taxpayer to report those changes within six months. The model statute is intended to bring uniformity to this area among the states. Currently there is a great deal of variety with some states requiring changes to be reported in as little as 90 days to as much as two years. This provision became effective July 1, 2006, and applies to federal determinations made on or after that date.

Filing Period for Nonresident Aliens

Section 6072(c) of the Code requires a nonresident alien to file an income tax return on or before the fifteenth day of the sixth month following the close of the taxable year (June 15th for taxpayer whose taxable year is the calendar year). Under previous State law, nonresident alien corporate taxpayers were required to file a State return by the fifteenth day of the third month following the close of the taxable year (March 15th for a calendar year taxpayer) and

nonresident alien individual taxpayers were required to file a State return by the fifteenth day of the fourth month following the close of the taxable year (April 15th for a calendar year taxpayer). Thus, under previous State law a nonresident alien was required to file a State income tax return before the federal tax return was due. This provision conforms the State filing deadlines to the federal filing deadlines for nonresident aliens and eases compliance burdens on those taxpayers. These provisions are effective for taxable years beginning on or after January 1, 2006.

Credit for Child-Care and Certain Employment-Related Expenses

Previous State law allowed a credit to a taxpayer who was eligible for the federal credit for child-care and employment-related expenses. The amount of the credit is based on a percentage of those expenses up to a certain amount. For the State credit, the amount of expenses that were taken into consideration when computing the credit were capped at $2,400 when there was one qualifying individual in the household and $4,800 when there was more than one qualifying individual in the household. Until 2003, these limits were the same as those at the federal level. In 2003, the federal limits increased to $3,000 and $6,000 respectively. This provision conforms the State limits to the federal limits. This provision also clarifies that the amount of expenses used in calculating the credit may not include any amount excluded from gross income. This provision is effective for taxable years beginning on or after January 1, 2006.

Updated References to Internal Revenue Code

North Carolina's tax law tracks many provisions of the federal Internal Revenue Code by reference to the Code.[2] The General Assembly determines each year whether to update its reference to the Internal Revenue Code.[3] 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. This act changes the reference date from January 1, 2005, to January 1, 2006.

Between January 1, 2005, and January 1, 2006, there were four major pieces of federal legislation that made changes to the Internal Revenue Code. This federal legislation includes the Energy Tax Incentive Act of 2005 (P.L. 109-58) signed into law on August 8, 2005, the Safe, Accountable, Flexible, Efficient Transportation Equity Act of 2005 (P.L. 109-59) signed into law on August 10, 2005, the Katrina Emergency Tax Relief Act of 2005 (P.L. 109-73) signed into law on September 23, 2005, and the Gulf Opportunity Zone Act of 2005 (P.L. 109-135) signed into law on December 21, 2005.

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[2] 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.

[3] 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."

- Energy Tax Incentive Act of 2005 (P.L. 109-58) (hereinafter Energy Act): Many of the changes made in this act involve tax credits for various activities. Because they are tax credits, these provisions do not have a direct impact at the State level. There are, however, several provisions that could have an impact at the State level, most of which involve the depreciation, amortization, or expensing of certain items.
    - *Elimination of deduction for clean-fuel vehicles*. Under previous law, a taxpayer was allowed a deduction for the purchase of a qualified clean-fuel vehicle. A 'qualified clean-fuel vehicle' is any motor vehicle that may be propelled by a clean-burning fuel such as natural gas, liquefied natural gas, liquefied petroleum gas, hydrogen, electricity, or any other fuel at least 85% of which is methanol, ethanol, or other alcohol or ether. The maximum amount of the deduction varied depending on the type of vehicle purchased. The deduction began to be phased out in 2004, and was set to be eliminated after the 2006 taxable year. This act moves up the phase-out so that the deduction is eliminated after the 2005 taxable year. In place of the deduction, this act creates a new federal credit for alternative fuel motor vehicles.
    - *Tax deferral for gains on electric transmission assets*. Under previous law, a taxpayer could elect to recognize qualified gain from a qualifying electric transmission transaction over an eight-year period. In order for a transaction to be a 'qualifying electric transmission transaction', numerous conditions had to be satisfied, one of which was that the transaction must have been completed before January 1, 2007. This act extends that date by one year to January 1, 2008.
    - *Deduction for nuclear decommissioning costs*. Utilities that own or operate a nuclear power plant are required by law to decommission the plant at the end of its useful life. A utility may elect to deduct contributions it makes to a nuclear decommissioning reserve fund established to help pay the costs associated with the eventual decommissioning. For previous tax years, contributions to such a reserve fund were limited to the lesser of the amount of nuclear decommission costs allocable to the fund that is included in the taxpayer's cost of services for ratemaking purposes for the taxable year and the ruling amount. The 'ruling amount' is a schedule obtained from the IRS that specifies the annual payments that must be made into the fund to cover the amount of the decommission costs allocable to the fund over its existence. This act eliminates the 'lesser of' test for taxable years beginning on or after January 1, 2006, and instead limits the deduction to the ruling amount.
    - *Energy efficient commercial buildings property deduction*. Despite the fact that large commercial buildings use approximately one-fourth of the electrical energy consumed in the nation, there was previously no federal tax incentive to encourage the use of energy-efficient property in the construction or renovation of commercial buildings. This act allows taxpayers to claim a deduction (as opposed to depreciation or amortization) with respect to costs associated with energy-efficient commercial building property placed into service between January 1, 2006, and January 1, 2008. The maximum amount that may be deducted is $1.80 per square foot of the building, less any amount deducted under this provision with respect to the same building in previous tax years. In order to qualify for the deduction, the following conditions must be satisfied: 1)

the costs must be associated with depreciable or amortizable property that is installed in a commercial building that meets certain standards for energy efficiency; 2) the property is installed as part of the interior lighting, heating, cooling, ventilation, or hot water systems or the building envelope; and 3) the property is installed as part of a plan to reduce the total annual energy costs of the building with respect to the interior lighting, heating, cooling, ventilation, and hot water systems by at least 50% as compared to a similar building that meets certain minimum standards for energy efficiency. The IRS is required to issue regulations relating to eligibility for a partial deduction and to the transfer of a deduction from a public entity (like the State) to the person responsible for designing the property.

- *Recapture of section 197 amortization.* Generally, property subject to amortization under section 197 of the Code is intangible property that is purchased and held by a taxpayer in the course of a business. Section 197 property includes goodwill, covenants not to compete, patents, copyrights, trademarks and certain licenses. The cost of section 197 property is recoverable over fifteen years using straight-line depreciation. Under general rules, gain on the sale of depreciable property must be recaptured as ordinary income to the extent of depreciation deductions previously claimed. Under general rules, the recapture amount is computed separately for each piece of property. This act provides that if multiple pieces of section 197 property are sold or disposed of in a single transaction or series of transactions, then the taxpayer must compute the recapture as if all of the property were a single asset. The effect of this change is to maximize the amount of income treated as recapture, and thus as ordinary income, and to lessen the amount treated as a capital gain, which is taxed at a lower rate.

- *Depreciation of electric transmission property.* Generally, under the modified accelerated cost recovery system (MACRS), assets used in the transmission and distribution of electricity for sale have a 20-year recovery period. This act allows the costs of certain electric transmission property placed into service after April 11, 2005, to be recovered over 15 years instead of 20.

- *Expensing liquid fuel refineries.* Under previous law, petroleum refining assets were depreciated over a 10-year recovery period using the double declining balance method. Petroleum refining assets are assets used for distillation, fractionation, and catalytic cracking of crude petroleum into gasoline and other petroleum products. This acts allows a taxpayer to make an election to expense 50% of the cost of qualified refinery property in the year in which the property is placed into service. 'Qualified refinery property' includes any portion of a qualified refinery that satisfies the following conditions: 1) The original use of the property commences with the taxpayer; 2) The property is placed in service between August 8, 2005, and January 1, 2012; 3) The property satisfies certain production capacity requirements; 4) The property satisfies all applicable environmental laws in effect when it is placed into service; 5) No written binding contract for the construction of the property was in effect on or before June 14, 2005; and 6) The construction of the property is subject to a written binding contract entered into before January 1, 2008. A 'qualified refinery' is one that is located in the United States and that is designed to serve the primary purpose of processing liquid fuel from crude oil or qualified fuels (including shale and tar

sands and coal seams). The expensing election is not available with respect to a refinery that is used primarily as a topping plant, asphalt plant, lube oil facility, crude or product terminal, or blending facility.

- *Depreciation of natural gas distribution lines*. Under previous law, natural gas distribution lines installed by a gas company were depreciated over a 20-year period. This act allows natural gas depreciation lines placed in service between April 11, 2005, and January 1, 2011, to be depreciated over a 15-year period.
- *Depreciation of natural gas gathering pipelines*. Prior to the enactment of this act, there was a disagreement among the courts as to what asset class natural gas gathering pipelines owned by a nonproducer belonged. The IRS maintained, and this position was supported by the Tax Court, that these pipelines belonged to an asset class subject to depreciation over 15 years. The Courts of Appeals in the Sixth, Eighth, and Tenth Circuits, however, held that these pipelines belonged to an asset class subject to depreciation over seven years. There was agreement that natural gas gathering pipelines owned by a producer were part of the asset class subject to depreciation over seven years. This act clarifies that all natural gas gathering pipelines, regardless of ownership, are subject to depreciation over seven years. This provision applies to natural gas gathering pipelines placed in service after April 11, 2005.
- *Geological and geophysical costs amortized over two years*. Geological and geophysical costs are those incurred for the purpose of accumulating data that serves 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). Courts have held these costs to be capital in nature and allocable to the property acquired or retained. If no property was acquired or retained, the costs were treated as a capital loss. This act provides that these costs, when incurred in the United States for oil or gas exploration, shall be amortized ratably over a 24-month period beginning on the mid-point of the taxable year in which the costs were incurred. The act does not affect the treatment of costs incurred outside of the United States or with respect to exploration for minerals other than oil or gas.
- *84-month amortization of air pollution control facilities*. Previous law allowed taxpayers to amortize over a 60-month period a certified pollution control facility used in connection with a plant that was in operation before January 1, 1976. For certified pollution control facilities placed in service after April 11, 2005, this act eliminates the requirement that the property be used in connection with a plant that was in operation before 1976 if the plant is an electric generation plant that is primarily coal fired. For property that satisfies this criteria, the amortization period is 84 months. The act does not lengthen the amortization period for property that was covered by previous law, it provides a favored, though not as generously favored, method of depreciation for another class of property.

- Safe, Accountable, Flexible, Efficient Transportation Equity Act of 2005 (P.L. 109-59) (hereinafter SAFE Act): Although this act makes numerous tax changes at the federal level, these changes have little to no direct impact at the State level.

- Katrina Emergency Tax Relief Act of 2005 (P.L. 109-73) (hereinafter Katrina Act): 2005 was a record-setting year on the meteorological front. Not only did the year see a record number of named storms (27) and a record number of hurricanes (14), the year also included the costliest Atlantic hurricane on record and one of the deadliest, Hurricane Katrina. Hurricane Katrina made landfall along the Gulf Coast on August 29, 2005, as a Category 3 storm. Hurricane Katrina resulted in the deaths of more than 1,400 people and caused over $80 billion in property damage. In the aftermath of Hurricane Katrina, Congress took action to assist taxpayers in the affected region. On September 21, 2005, Congress passed the Katrina Emergency Tax Relief Act of 2005, which was signed into law by President Bush on September 23, 2005. The act is a collection of tax relief provisions for individuals and businesses. Below, the key provisions of this act that could have an impact on State revenues are summarized.
    - *General Provisions*. The act contains definitions of several key phrases that are used throughout the act. Under the act, 'Hurricane Katrina disaster area' means an area with respect to which a major disaster has been declared by the President before September 14, 2005, with respect to Hurricane Katrina. The states of Alabama, Florida, Louisiana, and Mississippi comprise the Hurricane Katrina disaster area. The act also defines the term 'core disaster area.' The core disaster area is a subset of the Hurricane Katrina disaster area that has been determined by the President to warrant individual or individual and public assistance from the federal government. The core disaster area covers certain counties and parishes in Alabama, Louisiana, and Mississippi.
    - *Retirement Funds*. The act contains a number of special rules related to retirement funds for people who lived in the Hurricane Katrina disaster area or the core disaster area. Generally, these provisions allow for a more liberal use of retirement funds for emergency needs than would otherwise be allowed without subjecting the taxpayer to some sort of penalty or disincentive. These provisions include the following:
        - *Tax favored withdrawals from retirement plans for relief relating to Hurricane Katrina*. Generally, a withdrawal from a qualified retirement plan, a tax-sheltered annuity, an IRA, or an eligible deferred compensation plan maintained by a state or local government is included in taxable income in the year in which it is made. In addition, a distribution that is received before death, disability, or the age of 59 ½ is generally subject to a 10% early withdrawal tax. Some distributions are known as eligible rollover distributions and are not included in taxable income or subject to the 10% penalty tax. These distributions must be rolled over into another qualified retirement account within 60 days. This act provides an exception to the 10% early withdrawal tax in the case of a qualified Hurricane Katrina distribution[4] from a qualified retirement plan, tax-sheltered annuity, or IRA. In addition, any amount required to be included in income as a result of a qualified Hurricane

[4] A 'qualified Hurricane Katrina distribution' is a distribution made from an eligible retirement plan on or after August 25, 2005, and before January 1, 2007, to an individual whose primary place of abode on August 28, 2005, is located in the Hurricane Katrina disaster area and who has sustained an economic loss due to Hurricane Katrina. The total amount of qualified Hurricane Katrina distributions to a taxpayer from all accounts may not exceed $100,000.

Katrina distribution is included in income in installments over the three-year period beginning with the year in which the distribution is made rather than entirely within the year that the distribution is made. Finally, any amount of a qualified Hurricane Katrina distribution that is recontributed to an eligible retirement account within the three-year period is treated as a roll-over distribution and is not included in income.

- *Recontribution of withdrawals for home purchases cancelled due to Hurricane Katrina.* There is an exception to the 10% early withdrawal tax discussed above in the case of a qualified first-time homebuyer distribution from an eligible retirement account. A qualified first-time homebuyer distribution is one that does not exceed $10,000 and that is used within 120 days of the distribution for the purchase or construction of a principal residence of a first-time homebuyer. If the distribution is not used for the purchase of the home within 120 days or is not rolled over into an eligible retirement account within 60 days, the distribution is included in income and is subject to the 10% early withdrawal tax. This act allows a taxpayer who received a qualified distribution from a retirement account to recontribute that amount to an eligible retirement account without penalty. For the purposes of this provision, a 'qualified distribution' is a distribution that was received after February 28, 2005, and before August 29, 2005, and that was to be used to purchase or construct a principal residence in the Hurricane Katrina disaster area, but the residence is not purchased or constructed because of Hurricane Katrina. Any portion of a qualified distribution may be contributed to an eligible retirement account and treated as a roll-over if it is recontributed between August 25, 2005, and February 28, 2006. Because it is treated as a roll-over, that portion will not be included in income or subject to the 10% early withdrawal tax.

- *Loans from qualified plans for relief relating to Hurricane Katrina.* An individual is allowed to borrow from a qualified employer plan in which the individual participates provided the loan satisfies certain conditions. Generally, a loan from a qualified employer plan is treated as a taxable distribution of plan benefits. A loan is not treated as a tax distribution of benefits to the extent that the loan, when added to the outstanding balance of all other loans to the individual from all plans maintained by the employer, does not exceed the lesser of 1) $50,000 reduced by the excess of the highest outstanding balance of loans from such plans during the one-year period ending on the day before the date the loan is made over the outstanding balance of loans from the plan on the date the loan is made or 2) the greater of $10,000 or one half the individual's accrued benefit under the plan. For this exception to apply, the loan must have a repayment period of five years or less, must be amortized in level payments, and must have payments due at least quarterly. This act provides special rules in the case of a loan from a qualified plan to a qualified individual. For the purposes of this provision, a 'qualified individual' is one whose principal place of abode on August 28, 2005, is located in the Hurricane Katrina disaster area and who has sustained an economic loss because of Hurricane Katrina. Under this

provision, the loan limit discussed above is increased to the lesser of 1) $100,000 reduced by the excess of the highest outstanding balance of loans from such plans during the one-year period ending on the day before the date the loan is made over the outstanding balance of loans from the plan on the date the loan is made or 2) the greater of $10,000 or the individual's accrued benefit under the plan. In addition, this act provides that in the case of a qualified individual with an outstanding loan from a qualified plan on or after August 25, 2005, if the due date for any repayment with respect to the loan occurs during the period from August 25, 2005, to December 31, 2006, the due date is delayed for one year.

- *Charitable Giving Incentives*. In the wake of Hurricane Katrina, people from around the nation rushed to the aid of people in the affected areas with unprecedented amounts of charitable giving. As part of this act, Congress further encouraged and rewarded charitable giving.
  - *Temporary suspension of limitations on charitable contributions*. In general, the income tax deduction allowed for charitable contributions is subject to limitations based on the type of taxpayer, the property contributed, and the donee organization. Subject to certain limitations, discussed further below, the following general rules apply: 1) Contributions of cash are deductible in the amount contributed; 2) Contributions of capital gain property[5] to a qualified charity are deductible at fair market value; 3) Contributions of other appreciated property are deductible at the donor's basis in the property; and 4) Contributions of depreciated property are deductible at the fair market value of the property. Most contributions are subject to percentage limitations. For individuals, the amount deductible is limited to a percentage of the taxpayer's contribution base[6] The percentage varies depending on the type of donee organization and the type of property contributed. Contributions by an individual of property other than appreciated capital gain property to a charitable organization described in section 170(b)(1)(A) of the Code (public charities, private foundations other than private non-operating foundations, and certain governmental units) are deductible up to 50% of the contribution base. Contributions of this type of property to nonoperating private foundations and certain other organizations are deductible up to 30% of the contribution base. Contributions of appreciated capital gain property to an organization described in section 170(b)(1)(A) of the Code are generally deductible up to 30% of the contribution base. A taxpayer may elect to bring all of these contributions of appreciated capital gain property under the 50% limitation by reducing the amount of the deduction by the amount of the appreciation of the property. Contributions of appreciated capital gains property to a private nonoperating foundation are deductible up

[5] 'Capital gain property' means any capital asset or property used in the taxpayer's trade or business the sale which at its fair market value, at the time of contribution, would have resulted in a gain that would have been a long-term capital gain.

[6] The 'contribution base' is the taxpayer's adjusted gross income computed without regard to any net operating loss carryback.

to 20% of the contribution base. For corporations, charitable contributions are deductible up to 10% of the corporations taxable income computed without regard to net operating loss or capital loss carrybacks. For both individuals and corporations, excess charitable contributions may be carried forward for up to five years. There is also an overall limitation on most itemized deductions for individuals. The total amount of otherwise allowable itemized deductions is reduced by three percent of the amount of the taxpayer's adjusted gross income in excess of a certain threshold. However, the otherwise allowed deductions may not be reduced by more than 80%. This reduction is reduced to two percent for the 2006 and 2007 taxable years and to one percent for the 2008 and 2009 taxable years, is repealed for the 2010 taxable year, and is reinstated for the 2011 taxable year. This act provides several exceptions to the limitations on charitable contribution deductions. For individuals, the deduction for qualified contributions is allowed up to the amount by which the taxpayer's contribution base exceeds the taxpayer's deductions for other charitable contributions. In most cases, this means that an individual may deduct charitable contributions up to 100% of the taxpayer's adjusted gross income computed without regard to any net operating loss carryback. For corporations, the deduction for a qualified contribution is allowed up to the amount by which the corporation's taxable income exceeds the deduction for other charitable contributions. For the purposes of these provisions, a 'qualified contribution' is a cash contribution that is made between August 28, 2005, and December 31, 2005, to an organization described in section 170(b)(1)(A) of the Code. The term does not include a contribution of noncash property or one that is for the establishment or maintenance of a segregated fund or account with respect to which the donor reasonably expects to have advisory privileges with respect to the fund or account because of his status as donor. In the case of a corporation, the contribution must be for relief efforts related to Hurricane Katrina in order to be a qualified contribution. In addition, for individuals the charitable deduction contribution, up to the amount of qualified contributions, is not treated as an itemized deduction and is not subject to the reduction for higher-income taxpayers.

- *Additional exemption for housing Hurricane Katrina displaced individuals.* In the aftermath of Hurricane Katrina, hundreds of thousands of residents of the affected areas were displaced. During this time of displacement, many individuals opened their homes to those who had been displaced. Generally, individuals are allowed personal exemptions in computing taxable income. Personal exemptions are allowed for the taxpayer, the taxpayer's spouse, and the taxpayer's dependents. Personal exemptions are phased out for higher-income taxpayers. This act allowed a taxpayer an additional $500 exemption for each Hurricane Katrina displaced individual of the taxpayer, up to a maximum additional exemption of $2,000. The additional exemption is not subject to the phase out for higher-income taxpayers. For the purposes of this provision, a 'Hurricane Katrina displaced individual' is a person 1) whose principal place of abode on August 28, 2005, was in the Hurricane

Katrina disaster area, 2) who was displaced from the abode, 3) who is provided housing free of charge in the taxpayer's principal place of residence for a period of 60 consecutive days that ends in the taxable year in which the exemption is claimed, and 4) who is not the spouse or dependent of the taxpayer. For a person whose principal place of abode on August 28, 2005, was outside of the core disaster area, the person's abode must have been damaged by Hurricane Katrina or the person must have been evacuated from the abode by reason of Hurricane Katrina.

- *Increase in standard mileage rate for charitable use of vehicles.* In determining the amount of the charitable contribution deduction when a taxpayer operates a vehicle in providing donated services to a charity, the taxpayer may either deduct actual operating expenditures or use the charitable standard mileage rate. The charitable standard mileage rate, 14 cents per mile, is significantly less than the business standard mileage rate[7] The charitable rate is less than the business rate because it is meant to offset direct operating expenses only, such as gas, and not other expenses, such as a depreciation, insurance, or general maintenance. This act allows a taxpayer who uses a vehicle in providing donated service to charity for Hurricane Katrina relief only to compute the charitable mileage deduction at a rate equal to 70% of the business standard mileage rate, rounded to the next highest cent, on the date of the contribution. In the alternative, the taxpayer may continue to use actual operating expenditures to determine the amount of the deduction.
- *Mileage reimbursement to charitable volunteers excluded from gross income.* Volunteer drivers who are reimbursed for mileage expenses have taxable income to the extent that the reimbursement exceeds deductible expenses computed using either direct expenses or the charitable standard mileage rate. Under this act, reimbursement for mileage expenses by a charitable organization described in section 170(c) of the Code to a volunteer for the costs of using a passenger vehicle for Hurricane Katrina relief only is not included in income to the extent that the reimbursement does not exceed the amount that would be allowed using the business standard mileage rate. A taxpayer may not claim a deduction or credit for amounts excluded under this provision.
- *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 of 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

[7] For expenses incurred between January 1, 2005, and September 1, 2005, the standard business mileage rate was 40.5 cents per mile. For expenses incurred between September 1, 2005, and January 1, 2006, the standard business mileage rate was 48.5 cents per mile.

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.

- *Charitable deduction for contribution of book inventories.* As with contributions of food inventories above, 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, that is an educational organization that normally maintains a regular faculty and curriculum, and that normally has a regularly enrolled body of pupils in attendance at the place where its education activities are regularly conducted.

- *Miscellaneous Provisions.*
  - *Exclusion for certain cancellations of indebtedness by reason of Hurricane Katrina.* Gross income includes income that is realized by a debtor for the discharge of indebtedness, subject to certain exceptions. This act provides that the gross income of a qualified individual does not include any amount which would otherwise by includible in gross income by reason of a discharge of nonbusiness debt if the indebtedness is discharged by an applicable entity. The relief allowed under this provision does not apply to any indebtedness to the extent that real property outside of the Hurricane Katrina disaster area serves as security for the debts. For the purposes of this provision, a 'qualified individual' is any natural person whose principal place of abode on August 25, 2005, was located 1) in the core disaster area or 2) in the Hurricane Katrina disaster area and the person suffered economic loss as a result of Hurricane Katrina. An 'applicable entity' includes the following: a financial institution; a credit union; a corporation that is a direct or indirect subsidiary of a financial institution or credit union and as such is subject to regulation by federal or state agencies; the Federal Deposit Insurance Corporation, the Resolution Trust Corporation, the National Credit Union Administration, and certain other federal executive agencies; an executive, judicial, or legislative agency; and any other organization for whom the lending of money is a significant trade or business.

- *Suspension of certain limitations on personal casualty losses*. A taxpayer may generally claim a deduction for any loss sustained during the taxable year for which he is not compensated by insurance or otherwise. For individuals, the loss must be incurred in a trade or business or consist of property loss attributable to casualty or theft. Losses are deductible only if they exceed $100 per casualty or theft and total casualty and theft losses exceed 10% of the taxpayer's adjusted gross income. This act removes the $100 and 10% limitations on casualty and theft losses to the extent those losses are in the Hurricane Katrina disaster area on or after August 25, 2005, and are attributable to Hurricane Katrina.

- *Required exercise of IRS administrative authority*. In general, the Secretary of the Treasury may grant reasonable extensions of time to taxpayers to perform certain acts. In addition, for certain military personnel, the time period for performing certain acts (such as filing returns, paying taxes, bringing suit) is automatically suspended. In the case of a Presidentially declared disaster or terroristic or military action, the Secretary has the authority to prescribe a period of up to one year in which the time period for the same actions is suspended. This act requires the Secretary to suspend those time periods at least until February 28, 2006, for taxpayers determined to have been affected by the Presidentially declared disaster relating to Hurricane Katrina. In addition, this act adds employment and excise taxes to the list of taxes for which the Secretary may extend filing and payment time periods.

- *Special rules for mortgage revenue bonds*. A qualified mortgage bond is a type of private activity bond for which interest is excluded from gross income. Qualified mortgage bonds are issued to make mortgage loans to qualified mortgagors for the purchase, improvement, or rehabilitation of owner-occupied residences and to finance qualified home improvement loans. There are several limitations on qualified mortgage bonds, including income limitations for homebuyers, purchase price limitations, and the requirement that the mortgagor be a 'first-time homebuyer' – one that did not have any ownership interest in a primary residence for the previous three years. The first-time home buyer requirement does not apply to targeted area residences – one that is located in an area of chronic economic distress or a census tract in which at least 70% of the families have an income that is 80% or less of the statewide median income. A qualified home improvement loan may not exceed $15,000. This act eliminates the first-time homebuyer requirement with respect to qualified Hurricane Katrina recovery residences. A 'qualified Hurricane Katrina recovery residence' is one that is financed before January 1, 2008, and is either 1) located in the core disaster area or 2) the mortgagor of which owned a principal residence in the Hurricane Katrina disaster area that was rendered uninhabitable by Hurricane Katrina and the residence financed is in the same state as the previous residence. The act also increases the maximum amount of a qualified home improvement loan to $150,000 for residences located in the Hurricane Katrina disaster area to the extent that the loan is for repair of damage caused by Hurricane Katrina.

- *Extension of replacement period for nonrecognition of gain.* A taxpayer generally realizes gain to the extent the sales price of property exceeds the taxpayer's basis in the property. The realized gain is subject to taxation unless it is deferred or not recognized under some special provision. Gain realized by a taxpayer from an involuntary conversion of property is deferred to the extent the taxpayer replaces the property within the applicable period. The applicable period begins when property is converted and ends two years after the close of the first taxable year in which the gain is realized. This act extends the applicable period from two years to five years for property that is located within the Hurricane Katrina disaster area that is compulsorily or involuntarily converted after August 25, 2005, by reason of Hurricane Katrina. Substantially all of the use of the replacement property must be in this area for this provision to apply.
- *Secretarial authority to make adjustments regarding taxpayer and dependency status for taxpayers affected by Hurricane Katrina.* This provision allows the Secretary of the Treasury to make adjustments to the tax laws to ensure that taxpayers do not lose eligibility for credits or deductions or experience a change in filing status due to temporary relocations caused by Hurricane Katrina. An example of such an adjustment would be allowing a parent to claim a personal exemption for a child even if the child did not satisfy the residency requirement as a result of a relocation due to Hurricane Katrina. Any adjustment must ensure that an individual is not taken into account by more than one taxpayer with respect to the same benefit.

- Gulf Opportunity Zone Act of 2005 (P.L. 109-135) (GO Act): The Gulf Opportunity Zone Act of 2005 expanded upon the relief offered in the Katrina Emergency Tax Relief Act of 2005. In some instances, this expansion meant extending the additional benefits allowed under the Katrina Act to taxpayers affected by Hurricanes Rita or Wilma. In other cases, the expansion created new tax benefits for taxpayers in one or more of the disaster areas. The act also made numerous technical corrections.
  - *General Provisions.* First, the GO Zone Act added several new definitions. First, the 'Gulf Opportunity Zone' or 'GO Zone' is a subset of the Hurricane Katrina disaster area that has been determined by the President to warrant individual or individual and public assistance from the federal government and is the same as the 'core disaster area' under the Katrina Act. The 'Hurricane Rita disaster area' means an area with respect to which the President has declared a major disaster before October 6, 2005, with respect to Hurricane Rita. The 'Hurricane Wilma disaster area' means an area with respect to which the President has declared a major disaster before November 14, 2005, with respect to Hurricane Wilma. The 'Rita GO Zone' and 'Wilma GO Zone' are, respectively, the portions of the Hurricane Rita disaster area and Hurricane Wilma disaster area that have been determined by the President to warrant individual or individual and public assistance from the federal government.
  - *Extensions of Hurricane Katrina benefits.* The GO Zone Act extended some of the benefits of the Katrina Act to areas affected by Hurricanes Rita and Wilma. The following changes fall into this category.

- *Retirement plans*. The specific provisions discussed under the Katrina Act were repealed and replaced with more general provisions relating to all of the hurricanes. The provisions under this act were substantively identical to those discussed under the Katrina Act with some timing differences related to the different dates of the three storms.
- *Casualty losses*. The specific provisions discussed under the Katrina Act were repealed and replaced with more general provisions relating to all of the hurricanes. The provisions under this act were substantively identical to that discussed under the Katrina Act with some timing differences related to the different dates of the three storms.
- *Secretarial authority to make adjustments*. The specific provisions discussed under the Katrina Act were repealed and replaced with more general provisions relating to all of the hurricanes. The provisions under this act were substantively identical to those discussed under the Katrina Act with some timing differences related to the different dates of the three storms.
- *Mortgage revenue bonds*. The first-time homebuyer requirement is eliminated for residences in the Rita GO Zone or the Wilma GO Zone. In addition, the increased maximum amount of a qualified home improvement loan is applied to residences in the Rita GO Zone and the Wilma GO Zone.

- *Housing relief for Hurricane Katrina*. As discussed above, the Katrina Act provided some relief to individuals who provided housing for Hurricane Katrina evacuees. In this act, Congress provided further tax relief relating to housing expenditures. Employer-provided housing is generally included in income as a form of compensation. An exception to this general rule exists when an employee is required to accept the lodging on business premises as a condition of employment. This act provides that a qualified employee's gross income does not include the value of any in-kind lodging furnished to the employee, the employee's spouse, or the employee's dependents by or on behalf of the qualified employer. The exclusion applies only to lodging furnished during the six-month period beginning January 1, 2006, and may not exceed $600 for any month in which lodging is furnished. For the purposes of this provision, a 'qualified employee' is an individual who on August 28, 2005, had a principal residence in the GO Zone and who performs substantially all of his or her employment services in the GO Zone for a qualified employer. For the purposes of this provision, a 'qualified employer' is an employer with a trade or business located in the GO Zone.
- *Depreciation and expensing*.
  - *Bonus depreciation for Gulf Opportunity Zone property*. In 2002 and 2003, Congress acted to allow for bonus depreciation (either 30% or 50% depending on when the property was purchased) for property that was purchased after September 10, 2001. In order to qualify for the bonus depreciation, the property had to have been placed into service before January 1, 2005. For certain transportation property, noncommercial aircraft, or property with a long production period, the property must have been placed into service before January 1, 2006.

This act allows a taxpayer to claim an additional first-year depreciation allowance equal to 50% of the adjusted basis of qualified Gulf Opportunity Zone property acquired on or after August 25, 2005, and placed into service before January 1, 2008 (the sunset date is January 1, 2009, for nonresidential real property and residential rental property). 'Qualified Gulf Opportunity Zone' property must satisfy all of the following conditions: 1) It must be depreciable modified accelerated cost recovery systems (MACRS) recovery property with a recovery period of 20 years or less, MACRS water utility property, qualified leasehold improvement property, off-the-shelf computer software, residential rental property, or nonresidential real property; 2) Substantially all use of the property must be in the active conduct of a trade or business of the taxpayer in the GO Zone; 3) The original use of the property in the GO Zone must commence with the taxpayer on or after August 25, 2005; 4) The property must be purchased on or after August 25, 2005; 5) No written binding contract for the purchase of the property may be in effect before August 25, 2005; and 6) The property must be placed in service before January 1, 2008 (January 1, 2009 for nonresidential real property and residential rental property). The term does not include property that is 1) mandatory alternative depreciation system (ADS) property; 2) tax-exempt bond-financed property; 3) qualified revitalization buildings or rehabilitation expenditures for which a deduction under section 1400I of the Code is claimed; or 4) property used in connection with a private or commercial golf course, a country club, a massage parlor, a hot tub facility, a suntan facility, a liquor store, or a gambling or animal racing property. In addition, this act allows the Secretary to extend the placed-in-service date for noncommercial aircraft and property with longer production periods for up to one year. This extension is granted on a case-by-case basis and may only be granted if the delay in placing the property into service was caused by one of the three hurricanes and the property is placed in service in the GO Zone, the Rita GO Zone, or the Wilma GO Zone.

- *Increase in limits on section 179 deductions*. Certain taxpayers may elect to claim a section 179 expense deduction on the cost of qualifying property rather than depreciating the property over time. For the 2003 through 2007 tax years, the maximum amount of the deduction is limited to $100,000, indexed for inflation.[8] This limitation is increased by $35,000 for property that is placed in service in the New York Liberty Zone, an empowerment zone, or a renewal community. The amount of the section 179 deduction is reduced to the extent that the total amount of property placed into service exceeds an investment threshold, currently set at $400,000, indexed for inflation.[9] The section 179 deduction may not exceed a taxpayer's taxable income from the active conduct of a trade or business. This act increases the maximum section 179 deduction for qualified GO Zone property by the lesser of $100,000 or the amount of property placed into service in the GO Zone.

[8] The adjusted dollar limitation is $105,000 for 2005 and $108,000 for 2006.
[9] The adjusted investment limitation is $420,000 for 2005 and $430,000 for 2006.

In addition it increases the total investment limitation by the lesser of $600,000 or the amount of property placed into service in the GO Zone. The increased amounts apply to property acquired on or after August 25, 2005, and placed into service before January 1, 2008. 'Qualified GO Zone property' must satisfy all of the following conditions: 1) It must be depreciable modified accelerated cost recovery systems (MACRS) recovery property with a recovery period of 20 years or less; 2) Substantially all use of the property must be in the active conduct of a trade or business of the taxpayer in the GO Zone; 3) The original use of the property in the GO Zone must commence with the taxpayer on or after August 25, 2005; 4) The property must be purchased on or after August 25, 2005; 5) No written binding contract for the purchase of the property may be in effect before August 25, 2005; and 6) The property must be placed in service before January 1, 2008. The term does not include property used in connection with a private or commercial golf course, a country club, a massage parlor, a hot tub facility, a suntan facility, a liquor store, or a gambling or animal racing property.

- *Deduction for demolition and clean-up costs.* Under general law, demolition costs are capitalized and added to the basis of the land on which the demolished building was located. The tax treatment of debris removal costs depends on the nature of the costs incurred. Debris removal costs that are in the nature of replacement must be capitalized and added to the basis of the property damaged. Other times, debris removal costs may be used to show a decrease in the fair market value of property which could be used to determine the amount of a casualty loss. This act allows a taxpayer to claim a current deduction for 50% of any qualified Gulf Opportunity Zone clean-up costs paid between August 25, 2005, and January 1, 2008. For the purposes of this provision, a 'qualified Gulf Opportunity Zone clean-up cost' is an amount paid for the removal of debris, or the demolition of structures, on real property located in the GO Zone if the real property is either held by the taxpayer for use in a trade or business or is inventory in the hands of the taxpayer.
- *Environmental remediation costs.* Under previous law, a taxpayer may elect to deduct, rather than capitalize, certain environmental remediation expenditures incurred in connection with property used in a trade or business for the production of income. This provision expired for expenditures incurred after December 31, 2005. This act extends the expiration date for that provision until December 31, 2007, for qualified environmental remediation expenditures incurred in connection with a qualified site in the GO Zone. In addition, expenditures incurred on or after August 25, 2005, with respect to petroleum products in the GO Zone are included in the deduction.

AMEND TAXATION OF LOGGING MACHINERY.

Session Law	Bill #	Sponsor

S.L. 2006-19 **HB 1938** **Rep. Wainwright; Church; McComas; Underhill; (Primary Sponsors)**

AN ACT TO TREAT COMMERCIAL LOGGING MACHINERY THE SAME AS FARM MACHINERY UNDER THE SALES TAX.

OVERVIEW: This act, which was a recommendation of the Revenue Laws Study Committee, exempts from the 1% privilege tax, with an $80 maximum tax per article, commercial logging machinery, attachments, repair parts for commercial logging machinery, lubricants applied to commercial logging machinery, and fuel to operate commercial logging machinery for use in commercial logging operations.

FISCAL IMPACT: Annual revenue loss is estimated to be $2.87 million.
(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2006 Session. Available in the Legislative Library.)

EFFECTIVE DATE: This act became effective when signed into law by the Governor on June 21, 2006, and applies to purchases made on or after July 1, 2006.

ANALYSIS: For years, State tax law has provided that the sales and use tax rate on mill machinery is 1%, with an $80 maximum tax per article. There has never been a specific reference in the sales tax statutes to machinery used in the forestry and logging business; however, based on a long-standing interpretation by the Department of Revenue, logging firms that had contracts with wood product manufacturers to cut timber were deemed entitled to the 1% rate, $80 cap based on the preferential rate afforded to manufacturing industries and plants.
For several years, North Carolina has worked toward simplifying its sales and use tax statutes in an effort to conform to the Streamlined Sales and Use Tax Agreement. One of the conforming changes the State had to make was to simplify its sales tax rates. Under the Streamlined Sales and Use Tax Agreement, a state must have one rate, with no caps or thresholds, as of January 2006.

Prior to January 1, 2006, North Carolina had several different rates, including this 1% rate with an $80 cap. To conform to the Streamlined Sales and Use Tax Agreement, the General Assembly changed how the State taxes items previously taxed at the 1% sales tax rate with an $80 cap:

- In 2001, at the request of North Carolina Citizens for Business and Industry, the General Assembly maintained the preferential tax rate on mill machinery by removing it from the sales tax statutes to the privilege tax statutes. By changing the nature of the tax from a sales tax to a privilege tax, the industry kept its preferential rate and the State conformed to the Streamlined Sales and Use Tax Agreement. The change from a sales tax to a privilege tax means that retailers are not responsible for collecting and remitting the tax. The change in the law, made in 2001, became effective January 1, 2006. Based upon the long-standing interpretation by the Department, this change encompassed machinery used in the forestry and logging business.

- In 2005, the General Assembly exempted from tax sales to farmers of machinery, attachments and repair parts for the machinery, and lubricants applied to the

machinery. It also expanded the 1% privilege tax with an $80 cap, originally enacted in 2001, to include manufacturing fuel and major recycling equipment.

Thus, as of January 1, 2006, purchases of mill machinery, which includes commercial logging equipment, and mill machinery parts or accessories and manufacturing fuel, became exempt from sales and use tax, but were subject to the new privilege tax. The privilege tax is imposed on the purchaser of qualifying property, and the purchaser is liable for accruing and remitting the tax to the Department of Revenue. Examples of qualifying commercial logging equipment include log skidders, log carts, tree shears, feller bunchers, winches, chain saws, tractors, axes, and mallets when the items are used to cut and transport timber to a wood products manufacturer.

This act treats commercial logging machinery and related items the same as farm machinery under the current sales tax laws. First, the act exempts commercial logging items from the 1%/$80 maximum privilege tax, to which they are currently subject. The act also creates a new exemption in the sales and use tax statutes for commercial logging machinery, attachments and repair parts, lubricants, and fuel used to operate commercial logging machinery. The language of the exemption tracks the current exemption for farm machinery, as enacted in S.L. 2005-276.

PROPERTY TAX CHANGES.

Session Law	*Bill #*	*Sponsor*
S.L. 2006-30	**HB 2097**	**Representative Brubaker**

AN ACT TO MAKE CLARIFYING CHANGES TO THE PROPERTY TAX LAWS.

OVERVIEW: This act, which was a recommendation of the Revenue Laws Study Committee, makes the following changes to the property tax laws:

- It allows the electronic listing of individual as well as business personal property.
- It clarifies that 60% of only the first month's interest collected on delinquent registered motor vehicle taxes is transferred to the Combined Motor Vehicle and Registration Account, not the total interest collected on the unpaid taxes.
- It gives a county board of equalization and review the authority to approve late applications for present use-value appraisal of property.
- It validates the current practice of allowing tax collectors to receive tax receipts for assessments that have been or are subsequently appealed to the Property Tax Commission and to send the taxpayer an initial bill for those taxes.

FISCAL IMPACT: This act does not impact State revenues and does not have a significant impact on local revenues.
(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2006 Session. Available in the Legislative Library.)

EFFECTIVE DATE: The act became effective when signed into law by the Governor on June 26, 2006.

ANALYSIS: This act makes several changes to the property tax statutes.

Electronic Listing

The General Assembly enacted legislation in 2001 to allow counties to adopt a resolution providing for the electronic listing of business personal property.[10] This act extends a county's authority to provide electronic listing to include individual personal property[11] as well as business personal property. If the county commissioners adopt such a resolution, then the assessor must include information on how to list electronically in the listing notice sent to taxpayers. An abstract submitted by electronic listing is considered filed when received in the office of the assessor.

This act does not extend the listing deadline for individual personal property. The listing period begins on January 1 and ends on January 31. A county may, for good cause, give an individual taxpayer an extension until April 15 to list personal property. Under current law, a county may extend the period for electronic listing of business personal property until June 1.

Clarifying Change

The act makes a clarifying change to legislation enacted during the 2005 Session. S.L. 2005-294 created a combined system for the registration and taxation of motor vehicles, effective July 1, 2009.[12] Under the new combined system, consumers will receive one statement per registered vehicle containing all the registration fees and property taxes due on the vehicle. The Division of Motor Vehicles, or its agent, will be responsible for collecting the fees and taxes due.

To pay for the new system, the 2005 legislation increased the first month's interest on delinquent registered motor vehicle taxes from 2% to 5%, effective January 1, 2006, and required that 60% of the interest collected on unpaid taxes be transferred on a monthly basis to the Combined Motor Vehicle and Registration Account in the Treasurer's Office. Funds in this Account may only be transferred to the DMV for the purpose of implementing the combined system, at the direction of the North Carolina Association of County Commissioners. The intent of the sponsors of the 2005 legislation was that 60% of only the first month's interest would be transferred to the Account, not the total interest collected on unpaid taxes. This act clarifies this intent.[13]

Late Application for Present Use-Value

The act gives a county board of equalization and review the authority to approve a late application for present use-value appraisal of property if the applicant demonstrates good cause for the delay.[14] If the county board of equalization and review is not in session, then the late filing may be approved by the board of county commissioners. Existing law provides for similar approval for late applications for property tax exemptions or exclusions.[15]

Tax Receipts for Assessments

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[10] S.L. 2001-279.

[11] Examples of individual personal property include automobiles, boats, and mobile homes.

[12] Section 31.5 of S.L. 2006-259 changed this effective date to July 1, 2010.

[13] In December 2005, the North Carolina Department of State Treasurer issued a memorandum directing counties to only remit 60% of the first month's interest to the Treasurer. The memorandum stated that this was the true intent of the legislation and that it anticipated that language clarifying this intent would be enacted during the 2006 Session. The memorandum was sent to all county managers, finance officers, tax administrators, tax assessors, tax collectors, and certified public accountants.

[14] Generally, an application for present-use value must be filed during the regular listing period: January 1 through January 31.

[15] G.S. 105-282.1(a1).

Each year the county board of commissioners or the municipal governing body directs the tax collector to collect taxes charged in the tax records and receipts. The tax receipt sets out the name and address of the taxpayer, the assessment of the taxpayer's property, the rate of tax levied, and the amount of property taxes and any penalties due. Prior law stated that no tax receipts could be delivered to the tax collector for any assessment appealed to the Property Tax Commission until the appeal had been finally adjudicated. In practice, boards of equalization and review often adjourn on June 30, except to hear appeals filed prior to June 30. The tax collector receives the tax receipts by August 1.

This act validates the current practice of allowing tax collectors to receive tax receipts for assessments that have been or are subsequently appealed to the Property Tax Commission, but clarifies that the tax collector may not seek any remedies for collection of the taxes or enforcement of the tax lien pending final adjudication of appeal from the assessment. The tax collector may, however, send an initial bill or notice to the taxpayer pending final adjudication. By providing notice pending appeal, the taxpayer may choose to avoid the amount of interest that accrues while the appeal is pending. If the taxpayer wins on appeal, the taxpayer receives a refund of any taxes paid plus interest. The current practice also puts a potential buyer of property on notice of a tax bill if the property is transferred pending the appeal.

The act also makes a conforming change in the law concerning the annual settlement the tax collector makes with the governing body of its taxing unit. A tax collector is liable for the faithful performance of his or her collection duties. Each year, a tax collector must make a sworn report to the governing body of the taxing unit showing what taxes remain unpaid at the end of the fiscal year. In this final settlement for the preceding fiscal year, a collector is charged with the total amount of taxes for collection, less any amounts that may be credited to the collector in the settlement. [16] This act adds to the list of items that may be credited to the collector the principal amount of taxes for any assessment appealed to the Property Tax Commission when the appeal has not been finally adjudicated.

SSTA SALES TAX DEFN/SALES TAX PAYMENTS.

Session Law	*Bill #*	*Sponsor*
S.L. 2006-33	**HB 1915**	**Representative Hill**

AN ACT TO INCORPORATE THE STREAMLINED SALES TAX DEFINITIONS CONCERNING TELECOMMUNICATIONS, TO SIMPLIFY THE TAX PAYMENT REQUIREMENTS FOR SEMIMONTHLY TAXPAYERS, AND TO TREAT TANGIBLE PERSONAL PROPERTY USED IN MODULAR HOMES THE SAME AS TANGIBLE PERSONAL PROPERTY USED IN OTHER HOMES.

OVERVIEW: This act, which was a recommendation of the Revenue Laws Study Committee, does three things:

[16] Charges include the total amount of all taxes placed in the collector's hands for collection for the year, all late-listing penalties and costs collected by the collector, all interests on taxes collected by the collector, and any other sums collected or received by the tax collector. Credits include all sums deposited by the collector to the credit of the taxing unit, releases allowed by the governing body, discounts allowed for early payment of taxes, the principal amount of taxes constituting liens against real property, the principal amount of taxes determined to be insolvent and to be allowed as credits, and any commission the collector is entitled to deduct from amounts collected.

- Incorporates several definitions from the Streamlined Sales Tax Agreement into North Carolina law.
- Changes the tax payment requirements for semi-monthly sales tax payers.
- Allows a credit for sales tax paid on tangible personal property that is added to a modular home and sold with the modular home.

FISCAL IMPACT: The changes made with respect to definitions under the Streamlined Sales Tax Agreement have no fiscal impact on the State, but the changes with respect to sourcing of prepaid wireless may have a minimal impact on local governments. Minimal to no fiscal impact is expected from the changes regarding tax payment schedules.
(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2006 Session. Available in the Legislative Library.)

EFFECTIVE DATE: Different parts of the act have different effective dates as described below.

ANALYSIS: The act makes the following changes to the revenue laws.

Streamlined Sales Tax Agreement

Sections 1 through 8 of the act modify the definitions that apply to telecommunications services for sales and use tax purposes. The changes were made to adopt the definitions in the Streamlined Sales Tax Agreement (hereinafter Streamlined Agreement). These changes become effective January 1, 2007.

Section 1 of the act makes the following changes in G.S. 105-164.3, the definitions section of the sales and use tax laws:

- Adds a definition of the term 'ancillary service' because the definitions in the Streamlined Agreement separate ancillary services from telecommunications services. Previous North Carolina law considered ancillary services to be part of telecommunications services. All of the ancillary services were taxed under previous law and will continue to be taxed.
- Modifies the definition of 'prepaid telephone calling service' to include the newly defined terms for 'prepaid wireless calling service' and 'prepaid wireline calling service'. Previous law did not distinguish between prepaid wireline and prepaid wireless. The definition of prepaid wireless was added to recognize that prepaid wireless includes whatever other services can be obtained with the same card used to obtain wireless telecommunications service. Prepaid cards are taxed at the point of sale rather than as telecommunications service when the minutes are used. Some services that are not within the definition of telecommunications service can be purchased with the card that authorizes prepaid wireless use. The current definition of prepaid telephone calling service has an exclusive use requirement that conflicts with the practice for prepaid wireless.
- Converts the current definition of prepaid telephone calling service into the definition of 'prepaid wireline calling service'. This change is technical.
- Adds a definition for 'prepaid wireless calling service'. This definition does not have an exclusive use requirement, in contrast to prepaid wireline.
- Updates the definition for 'Streamlined Agreement' to include the latest amendments made January 13, 2006.

- Conforms the definition of 'telecommunications service' to the Streamlined definition and incorporates into the definition the appropriate inclusions and exclusions that are now in G.S. 105-164.4C(b) and (c). As changed, the definition is the same as previous law with two exceptions. The first exception relates to Universal Service Fund surcharges. The second exception is related to paging service. With these changes, these charges are part of the sales price and will be subject to tax. Universal Service Fund surcharges could not be 'carved out' and remain as under previous law because there is no Streamlined carve out in sales price or telecommunications service for this surcharge. Paging service may be carved out because there is a Streamlined definition for this, but this act does not include that carve out.

Section 2 of this act changes the tax imposition statute to add the now separate category of 'ancillary service' and to include non-telecommunications services that are sold as part of a prepaid wireless calling service.

Section 3 of this act makes a conforming change to the sourcing statute to apply the new definition of prepaid wireless call service.

Section 4 of this act makes conforming changes to the separate statute on telecommunications to include ancillary service and to apply the new definition of prepaid wireless calling service.

Section 5 of this act moves to the exemption statute the items that were formerly excluded from the definition of telecommunications and are not intended to be taxed. This change maintains the current tax treatment of these services.

Sections 6 through 8 of this act add the now separate category of 'ancillary service' in the exemption statute, in the direct pay permit statute, and in the local distribution statute.

Section 12 of this act repeals the requirement that a certified automated system must be able to determine whether an exemption certificate offered by a purchaser is a valid certificate based upon a State registry because the Streamlined Agreement does not require this determination. The section became effective June 1, 2006, because the first certification of an automated system under the Streamlined Sales Tax Act occurred around that date. Under the Streamlined Sales Tax Act, a seller may collect and remit the sales and use tax due a state through either a certified service provider or it may do it itself through the use of a certified automated system. A certified automated system is a software program certified by the Secretary of Revenue as being able to correctly determine the applicable State and local sales tax rate. G.S. 105-164.44H(a) lists the specific requirements a certified automated system must meet to be certified. This section removes one of the requirements because it is not a requirement under the Agreement.

Sales Tax on Modular Homes

Previous law stated that the retail sale of a modular home was the sale of the home to a modular homebuilder. It assumed that a manufacturer would sell to a modular homebuilder who would then enter into a performance contract with a customer to construct the home. This assumption was not accurate when the manufacturer sold the modular home directly to the customer who would occupy the home.

Section 13 of the act addresses two issues. First, it clarifies the law concerning a retail sale of a modular home by including within the scope of a retail sale all sales to the customer who will occupy the home. It does this by removing the previous limitation that defined a retail sale as a sale to a modular homebuilder. Second, it allows a credit for sales and use tax paid on materials

used in the home. G.S. 105-164.6 allows a credit against this State's sales tax for any sales or use tax paid in another state on the same item. This provision does not apply, however, to taxes paid in another state on materials that are included in a modular home that is taxed when it is sold to a modular homebuilder because the taxes paid to the two states are on different items. This section allows credit for sales tax paid on the items that are included in the home.

This part of the act became effective July 1, 2006, and applies to purchases made on or after that date.

Simplify Semi-Monthly Tax Payments

Under previous law, taxpayers that were liable for at least $10,000 a month in sales tax, electric utility tax, or piped natural gas excise tax were required to pay tax twice a month. For these taxpayers, the month was split into two periods – the first day of the month through the 15th of the month, and the 16th of the month through the end of the month. The tax payment for the 1st through 15th period was due by the 25th of the same month and the tax payment for the 16th through the end of the month was due by the 10th day of the following month. Therefore, taxpayers had 10 days after the end of a semimonthly period to make a payment. In addition to the payments, these taxpayers also were required to file a return. The sales tax return was due monthly by the 20th and the electric utility and piped gas returns were, and remain, due quarterly by the end of the month after the close of the quarter.

Several large retailers in the Streamlined Sales Tax project asked North Carolina to look at its payment schedule to determine if it could require payments to be made only once a month. North Carolina is one of only a few states that require payments twice a month.

Sections 9, 10, and 13 of the act replace the semimonthly payment schedule with a single monthly payment and a prepayment of the next month's liability due on the same day as the monthly payment. The result is that taxpayers will have more time to gather data before filing a return and will make payments on only one day of the month. Under the act, the taxpayer makes one payment on the 20th of the month. That payment includes any amount remaining due for the preceding month and 65% of the amount estimated to be due for the current month. The State will experience a slight one-time increase in revenue in the first month that the prepayment schedule takes effect.

The prepayment must equal at least 65% of one of three thresholds:

- The current month's liability.
- The liability for the same month the preceding year.
- The average monthly liability for the past calendar year.

These thresholds are easily determined and eliminate the need for the taxpayer to calculate actual liability for periods of less than a month. The 65% threshold was chosen because it was suggested by the retailers who requested North Carolina to review its law and the prepayment date is about 2/3 of the time in a month. A similar method and threshold are already in place in Florida and Arkansas.

The act eliminates the provisions concerning penalty relief for small underpayments because the relief is no longer needed. The relief was provided under previous law because the law required taxpayers to calculate liability for short periods within 10 days after the end of the period. Under this act, sales tax taxpayers have 20 days after the end of the month to file a return and electric utility and piped gas taxpayers have a full month after the end of a quarter to file a return.

This part of the act becomes effective October 1, 2007.

MILL REHABILITATION TAX CREDIT.

Session Law	*Bill #*	*Sponsor*
S.L. 2006-40	**HB 474 As amended by S.L. 2006-252**[17]	**Rep. Ross, Howard, Brubaker, Goodwin**

AN ACT TO PROVIDE A TAX CREDIT FOR REVITALIZATION OF HISTORIC MILL FACILITIES AND TO PROVIDE AN ENHANCED HISTORIC REHABILITATION CREDIT FOR REHABILITATION EXPENSES WITH RESPECT TO A FACILITY THAT WAS ONCE A STATE-OWNED TRAINING SCHOOL FOR JUVENILE OFFENDERS.

OVERVIEW: This act does three things:

- It provides an enhanced credit for rehabilitating a facility that at one time was a State-owned training school for juvenile offenders.
- It provides an income tax credit for rehabilitating vacant historic manufacturing sites if the taxpayer spends at least $3 million to rehabilitate the site. The credit is a percentage of the qualified rehabilitation expenditures or rehabilitation expenses. The percentage amount of the credit varies depending on the development tier location of the site and its eligibility for the federal credit.
- It eliminates the requirement that in order for a project to be eligible for a credit for rehabilitating non-income producing property it must receive the certification of the State Historic Preservation Officer before the commencement of work.

FISCAL IMPACT: The act is expected to decrease General Fund revenues $2.8 million in fiscal year 2006-07. This loss grows to an anticipated $14.7 million in fiscal year 2008-09 before beginning to decline. Preservation NC estimates there are approximately 30 to 35 mill properties out of more than 200 eligible properties throughout North Carolina likely to be rehabilitated as a result of this tax credit.
(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2006 Session. Available in the Legislative Library.)

EFFECTIVE DATE: The act is effective for taxable years beginning on or after January 1, 2006, and applies to eligible sites placed into service on or after July 1, 2006. The act expires for qualified rehabilitation expenditures and rehabilitation expenses incurred on or after January 1, 2011.

ANALYSIS: North Carolina has two income tax credits for rehabilitating an historic structure. One credit is allowed to taxpayers that qualify for the federal historic rehabilitation credit. The federal tax credit is available for rehabilitating only income-producing historic structures, and is equal to 20% of the rehabilitation expenses. The amount of the North Carolina credit is 20% of the expenses that qualify for the federal credit. The second credit is allowed to taxpayers that rehabilitate an historic structure that is not income producing, and thus not eligible for the

[17] S.L. 2006-252 replaced the tax credits under the Bill Lee Act with more narrowly focused credits. The act replaced 'enterprise tiers' with 'development tiers' and reduced the number of tiers from five to three. S.L. 2006-252 made changes to this act to conform to the changes made in it.

federal credit. The credit is equal to 30% of the rehabilitation expenses. To qualify for the credit for rehabilitating a non-income producing historic structure, the taxpayer must spend more than $25,000 within a 24-month period. The North Carolina credit for both income-producing structures and non-income producing structures must be taken in installments over five years after the structure is placed in service, and any unused portion of the credit may be carried forward for five years. A pass-through entity may allocate the credit to an owner if an owner's adjusted basis in the pass-through entity is at least 40% of the amount allocated to that owner.

Enhanced Credit

The act amends the tax credit allowed for rehabilitating an historic structure by increasing the credit amount for rehabilitating a facility that was once a State-owned training school for juvenile offenders. The amount of credit such a facility may be eligible to receive is increased to 40% of the qualified rehabilitation expenditures or rehabilitation expenses rather than 20% or 30%, respectively. This provision allows for an enhanced credit for a rehabilitation of the facilities of the former Stonewall Jackson Manual Training and Industrial School in Cabarrus County.

Mill Rehabilitation Credit

The act also establishes an enhanced tax credit for rehabilitating vacant historic manufacturing sites. This credit may be taken in place of the existing credit for historic rehabilitation, not in addition to it. The tax credit enacted by this act for rehabilitating historic manufacturing sites differs from the tax credit for historic rehabilitation in several ways. The amount of the credit is larger, the credit may be taken against one of three taxes, in some instances the credit may be taken in the year the property is placed into service, and any unused portion of the credit may be carried forward for nine years.

To be eligible to claim the credit for rehabilitating a vacant historic manufacturing site, a taxpayer must spend at least $3 million to rehabilitate the site. To qualify for the credit, the site must satisfy all of the following conditions:

- The site was used as a manufacturing facility or for purposes ancillary to manufacturing, as a warehouse for selling agricultural products, or as a public or private utility.
- The site has been at least 80% vacant for a period of at least two years immediately preceding the date the eligibility certification is made.
- The site is a certified historic structure or a State-certified historic structure.

The amount of the credit depends upon the development tier in which the site is located and the eligibility of the site for a federal credit as follows:

- 40% of qualified rehabilitation expenditures or rehabilitation expenses – If the site is located in a development tier one or two, regardless of whether the taxpayer is allowed a federal credit.
- 30% of qualified rehabilitation expenditures – If the site is located in a development tier three and the taxpayer is allowed a federal credit.
- No credit is allowed if the site is located in a development tier three and the taxpayer is not allowed a federal credit.

If the credit is taken for income-producing property, it may be taken in the year the property is placed in service. If the credit is taken for non-income-producing property, the credit must be taken in five equal installments beginning with the taxable year in which the property is placed in service.

The credit allowed may be claimed against the income tax, the franchise tax, or the gross premium tax. The taxpayer must elect the tax against which the credit will be claimed, and this election is binding.

The credit may not exceed the amount of the tax against which the credit is claimed for the taxable year reduced by the sum of all credits allowed, except payment of tax made by the taxpayer. Any unused portion of the credit may be carried forward for nine years.

A pass-through entity may allocate the credit among any of its owners without limitation as long as the owner's adjusted basis in the pass-through entity is at least 40% of the amount of credit allocated to the owner.[18] An owner of a pass–through entity that qualifies for the credit will forfeit a portion of any credit the owner has received if both of the following conditions are met:

- The owner disposed of the interest within five years from the date the eligible site is placed into service.
- The owner's interest in the pass-through entity is reduced to less than two-thirds of the owner's interest in the pass-through entity at the time the eligible site was placed into service.

The forfeiture of an owner's interest is not required if the change in ownership is the result of the owner's death or the merger, consolidation, or similar transaction requiring approval by the shareholders, partners, or members of the entity, to the extent the entity does not receive cash or tangible property in the transaction. A taxpayer or owner of a pass-through entity that forfeits a credit is liable for all past taxes avoided as a result of the credit plus interest computed from the date the taxes would have been due if the credit had not been allowed.

Certification by the State Historic Preservation Officer

To qualify for either the historic rehabilitation tax credit or the mill rehabilitation tax credit, the State Historic Preservation Officer must certify that the facility comprises an eligible site and that the rehabilitation is a certified rehabilitation. A taxpayer must provide the Secretary of Revenue with documents showing that the State Historic Preservation Officer certifies the site and rehabilitation and showing the amount of rehabilitation expenditures or expenses. Under prior law, the certification of the repairs or alterations had to be obtained by the taxpayer from the State Historic Preservation Officer prior to the commencement of the work. This act eliminates the timing of this requirement for both the credit enacted by this act and for the pre-existing credit for rehabilitating an historic structure.[19]

MODIFY APPROPRIATIONS ACT OF 2005.

Session Law	*Bill #*	*Sponsor*

[18] A pass-through entity may also allocate the credit for rehabilitating an historic structure among its owners in the same manner as provided in this provision.

[19] The taxpayer is still required to receive certification from the State Historic Preservation Officer that the repairs or alterations comply with federal standards, but the timing of that certification is immaterial.

S.L. 2006-66 **SB 1741** **Senator Garrou**

AN ACT TO MODIFY THE CURRENT OPERATIONS AND CAPITAL APPROPRIATIONS ACT OF 2005, TO INCREASE TEACHER AND STATE EMPLOYEE PAY, TO REDUCE THE SALES TAX RATE AND THE INCOME TAX RATE APPLICABLE TO MOST SMALL BUSINESSES, TO CAP THE VARIABLE WHOLESALE COMPONENT OF THE MOTOR FUEL TAX RATE AT ITS CURRENT RATE, TO ENACT OTHER TAX REDUCTIONS, AND TO PROVIDE FOR THE FINANCING OF HIGHER EDUCATION FACILITIES AND PSYCHIATRIC HOSPITALS AND OTHER CAPITAL PROJECTS.

OVERVIEW: This act is The Current Operations and Capital Improvements Appropriations Act of 2006. In addition to the budget provisions, the act makes many tax law changes and authorizes the issuance of special indebtedness to finance several capital projects across the State. The tax law changes made in this act include the following:

- It reduces the sales tax rate from 4.5% to 4.25%, effective December 1, 2006.
- It reduces the upper individual income tax bracket from 8.25% to 8%, effective for taxable years beginning on or after January 1, 2007, and from 8% to 7.75%, effective for taxable years beginning on or after January 1, 2008.
- It caps the variable wholesale component of the motor fuels tax rate for one year and holds the Highway Fund harmless for any potential revenue loss.
- It creates a new tax credit for small businesses that provide health benefits to their eligible employees, effective for taxable years beginning on or after January 1, 2007, and expiring for taxable years beginning on or after January 1, 2009.
- It extends the sunset for refunds of the State sales and use tax on fuel used by interstate passenger air carriers and on aviation fuel used by a motorsports racing team or a motorsports sanctioning body. The refunds were scheduled to expire for purchases made on or after January 1, 2007; the act extends the date of expiration to January 1, 2009.
- It extends the sunset on the tax credit for constructing renewable fuel production facilities from January 1, 2008, to January 1, 2011, and it creates an enhanced credit if the taxpayer invests at least $400 million in three separate facilities over a five-year period.
- It creates a tax credit for certain biodiesel providers, effective January 1, 2007, and expiring January 1, 2010.
- It exempts qualifying research and development equipment from State and local sales and use tax and imposes a 1% privilege tax with an $80 cap, effective July 1, 2007.
- It provides a sales and use tax refund for a professional motorsports racing team for purchases of professional motor racing vehicle component parts other than tires or accessories made by it, effective July 1, 2007.
- It provides a married couple with the option of filing jointly if they file a federal joint return and if one spouse is a nonresident with no income from North Carolina, effective for taxable years beginning on or after January 1, 2006.

- It allows an individual taxpayer to deduct a maximum amount of $750 contributed by the taxpayer to an account in the Parental Savings Trust Fund. A married couple filing jointly may deduct a maximum of $1,500. To qualify for the deduction, the adjusted gross income of the individual taxpayer or married couple filing jointly must not exceed a specified amount. The deduction is effective for taxable years beginning on or after January 1, 2006. The deductible amount increases for taxable years beginning on or after July 1, 2007. The deduction is repealed for taxable years beginning on or after January 1, 2011.
- It provides an exemption from the sales and use tax on sales of tangible personal property and electricity to an eligible Internet data center, effective for sales made on or after October 1, 2006.
- It amends the definition of 'corporation', as it applies to the franchise tax statutes, to include a limited liability company (LLC) that elects to be taxed as a C Corporation for federal income tax purposes. The effect of this change is that the corporate franchise tax will apply to these LLCs. The change is effective for taxable years beginning on or after January 1, 2007.
- It expands the royalty payment reporting option for corporations and their related members to include payments received for use of patents and copyrights, effective for taxable years beginning on or after January 1, 2006.

FISCAL IMPACT: The tax changes enacted in this act reduce General Fund revenues by approximately $193.5 million for fiscal year 2006-2007. The act authorizes approximately $254 million in special indebtedness for the fiscal year 2006-2007, and another $419 million in the future.
(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2006 Session. Available in the Legislative Library.)

EFFECTIVE DATE: The act contains varying effective dates.

ANALYSIS: The act makes the following finance law changes.

Transfer of Tax Proceeds from Highway Trust Fund to General Fund.

Each fiscal year, a certain sum of highway use tax proceeds is transferred from the Highway Trust Fund to the General Fund. The first amount is equal to $1.7 million. In 2005, the General Assembly altered that amount for fiscal years 2005-2006 and 2006-2007 by requiring a transfer of $250 million in each of those fiscal years. Section 2.2(e) of the act reduces the transfer amount to $55 million for fiscal year 2006-2007 only.

The second amount required to be transferred annually from the Highway Trust Fund to the General Fund is determined by a formula. The formula is determined by adjusting the amount distributed in the previous fiscal year, which began as a base of $2.4 million in fiscal year 2002-2003, plus or minus a percentage of this sum equal to the percentage by which tax collections have increased or decreased for the most recent 12-month period for which data is available. Using this formula, the second amount transferred to the General Fund for fiscal year 2006-2007 is $2,486,602.

Consultation Not Required Prior to Establishing or Increasing Fees pursuant to the Executive Budget Act

Section 6.3 of the act provides that an agency is not required to consult with the Joint Legislative Commission on Governmental Operations pursuant to G.S. 12-3.1[20] prior to establishing or increasing a fee authorized or anticipated in the Current Operations and Capital Improvements Appropriations Act of 2006, or in the Senate and House of Representatives Appropriations Committee Reports on the Continuation, Expansion and Capital Budgets, that were distributed in the Appropriations and Base Budget Committees and used to explain this act. The statutory consultation requirement is unnecessary since the General Assembly already considered these fees in the Appropriation Act of 2006 and Committee Reports.

No Increases that the General Assembly has Rejected

Section 6.4 of the act amends the Executive Budget Act by adding a statute prohibiting a fee increase if the General Assembly has rejected an increase in that fee for the current fiscal period. For purposes of this section, the General Assembly has rejected a fee increase when that fee is included in a bill which fails a reading or is in a version of a bill that passes one house but is enacted without the fee increase.

Refund of Local Sales and Use Taxes to a Local School Administrative Unit

Prior to the 2006-2007 fiscal year, local school administrative units were eligible for an annual refund of sales and use taxes paid by the unit. In 2005, the General Assembly repealed the provision which authorized the refund for local school administrative units in an attempt to redirect estimated State sales tax revenues refundable to LEAs to the State Public School Fund for allotment through State position, dollar, and categorical allotments. However, the amount that was transferred to the State Public School Fund was sufficient to offset only the State portion of the taxes that were previously refunded. The effect of this was to reduce the amount going to the public schools. Section 7.20 of the act maintains the repeal of the refund of the State taxes, but allows local school administrative units to apply for a refund of the local sales and use taxes paid by the unit. As before, the refund applies to sales and use taxes paid on direct purchases of tangible personal property, other than telecommunications and electricity, and indirect purchases of building materials. Also as before, the request for a refund must be in writing and is due within six months after the end of the entity's fiscal year. This is the only instance in which a taxpayer is eligible for a refund of local sales and use taxes when the taxpayer is not also eligible for a refund of State sales and use taxes. This change is effective retroactive for purchases made on or after July 1, 2005.

Revised Maximums for Collection Assistance Fees

Section 19.2 of the act increases the maximum amount of collection assistance fee proceeds that the Department of Revenue may apply to taxpayer locator services from $100,000 to $150,000 per year and adds a yearly limit of $353,000 to the amount of the fees that may be applied towards postage or other delivery charges for correspondence related to collecting overdue tax debts. In 2001, the General Assembly established a system under which the cost of collecting overdue tax debts is to be borne by the delinquent taxpayers, not by the taxpayers who pay their taxes on time. The collection assistance fee is 20% of the overdue tax

[20] G.S. 12-3.1 provides that before an agency's rule to establish or increase a fee can become effective, the agency must consult with the Joint Legislative Commission on Governmental Operations on the amount and purpose of the fee to be established or increased. If the Commission does not hold a meeting to hear the consultation request within a specified time, then the consultation requirement is deemed satisfied.

debt and is a receipt of the Department.[21] The proceeds of the fee are credited to a special, non-reverting account to be used only for collecting overdue tax debts. The Department of Revenue may apply the fee proceeds for the following purposes:

- To pay contractors for collecting tax debts.
- To pay the fee charged by the federal government for collecting tax debts by offset.
- To pay for taxpayer locator services. Section 19.2 increases the dollar amount that may be used to pay for these services from a maximum of $100,000 a year to a maximum of $150,000 a year.
- To pay for postage or other delivery charges for correspondence relating to collecting overdue tax debts. Section 19.2 sets a dollar limit of $353,000 a year on the amount that may be used to pay for postage and delivery charges.
- To pay operating expenses for Project Collection Tax and the Taxpayer Assistance Call Center.
- To pay the expenses of the Examination and Collection Division related to collecting overdue tax debts.

Consolidate Tax Project Reports

Section 19.3 of the act moves the statutory requirement that the Department of Revenue report on its efforts to collect tax debts and on its use of the proceeds of the collection assistance fee from G.S. 105-243.1 to G.S. 105-256. G.S. 105-256(a) contains a list of the reports the Department must provide. This section adds the report of its collection efforts to this list.

Special Indebtedness Projects

Section 23.12 of the act authorizes the issuance of special indebtedness to finance the capital facility costs, including construction or renovation, of the following projects and in the following amounts:

- North Carolina Museum of Art - $40 million.
- Central Regional Psychiatric Hospital for the Department of Health and Human Services - $20 million.
- A new Secondary State Data Center - $24,841,300.
- A new Center City Classroom Building at the University of North Carolina-Charlotte - $45,827,400.
- The Department of Health and Human Services Public Health Laboratory and Office of Chief Medical Examiner - $101 million.
- The Eastern Regional Psychiatric Hospital for the Department of Health and Human Services - $145 million. The indebtedness must be incurred over a period of time:

[21] Section 22.6 of S.L. 2005-276 amended the law to provide that the amount of the collection assistance fee would be the actual cost of collection, not to exceed 20% of the amount of the overdue tax debt. However, Section 37 of S.L. 2005-345 subsequently repealed this section, leaving the amount of the collection assistance fee at 20% of the amount of the overdue debt.

no more than $20 million may be incurred prior to July 1, 2007; and no more than $100 million may be incurred prior to July 1, 2008.

- The Regional Medical Center and Mental Health Center of the Department of Correction - $132,200,000. The indebtedness must be incurred over a period of time: no more than $8.2 million may be incurred prior to July 1, 2007; no more than $58.2 million may be incurred prior to July 1, 2008; and no more than $98.2 million may be incurred prior to July 1, 2009.
- The Western Regional Psychiatric Hospital for the Department of Health and Human Services - $162.8 million. However, no indebtedness may be incurred prior to July 1, 2008.

Reduce Sales Tax Rate Early

Section 24.1 of the act provides for an earlier reduction of the State sales tax rate from 4.5% to 4.25%, effective December 1, 2006. Prior to October 16, 2001, the general rate of State sales tax was 4%. Effective October 16, 2001, the general rate was raised to 4.5%. The general rate was set for reduction back to 4% on July 1, 2007. This section moved up the date of reduction of the State sales tax to 4.25% from July 1, 2007, to December 1, 2006. The remaining quarter-cent will expire as scheduled on July 1, 2007. The cost of the early sales tax reduction is estimated at $140.1 million for 2006-07.

Reduce Income Tax Rate Applicable to Most Small Businesses Early

Section 24.2 of the act provides for an earlier reduction in the upper-income individual tax bracket rate than provided under previous law. The rate will be reduced from 8.25% to 8%, effective for taxable years beginning on or after January 1, 2007.[22] The rate will then be further reduced to 7.75% in 2008 as provided under previous law. In 2001, the General Assembly added a new tax bracket that imposed an additional one-half percent income tax (a total rate of 8.25%) on certain North Carolina taxable income for three years. In 2003 the General Assembly extended the rate to 2006[23] and in 2005 the General Assembly extended the rate until 2008.[24] The change was estimated to affect approximately 2% of North Carolina taxpayers. The anticipated impact of this change on General Fund revenues is a one-time reduction of $28.6 million in non-recurring revenues in FY 2006-07.

Prior to 2001, tax was imposed at the following rates on individuals' North Carolina taxable income:

Tax Rate	Married filing jointly	Heads of household	Single filers	Married filing separately
6%	Up to $21,250	Up to $17,000	Up to $12,750	Up to $10,625
7%	Over $21,250 and up to $100,000	Over $17,000 and up to $80,000	Over $12,750 and up to $60,000	Over $10,625 and up to $50,000
7.75%	Over $100,000	Over $80,000	Over $60,000	Over $50,000

[22] The Governor's budget recommended a phase down of the upper income tax rate to 8% in 2006 and the elimination of this bracket in 2007.
[23] S.L. 2003-284, Section 39.1.
[24] S.L. 2005-276, Section 36.1.

The 2001 law created a fourth tax bracket for North Carolina taxable income as follows:

Tax Rate	Married filing jointly	Heads of household	Single filers	Married filing separately
8.25%	Over $200,000	Over $160,000	Over $120,000	Over $100,000

Cap Variable Wholesale Component of Motor Fuels Tax Rate and Hold Highway Fund Harmless

A motor fuel excise tax is imposed on all motor fuel sold, distributed, or used in the State. The rate of tax consists of a flat rate of 17.5¢ per gallon plus a variable wholesale component equal to the greater of 7% of the average wholesale price of motor fuel during a base six-month base period or 3.5¢ per gallon. The variable wholesale rate for the period of January 1, 2006, through June 30, 2006 was 12.4¢ per gallon, and the total rate was 29.9¢ per gallon. One-half cent per gallon of the excise tax is allocated to various environmental funds. Of the remaining excise tax revenue, 75% goes to the Highway Fund and 25% goes to the Highway Trust Fund.

Section 24.3 of the act caps the variable wholesale component of the motor fuel excise tax rate at its current rate of 12.4¢ per gallon for the period of July 1, 2006, through June 30, 2007. In addition, Section 2.2(g) of the act provides a reserve in the General Fund for the purpose of holding harmless the Highway Fund and the Highway Trust Fund in the event that the variable wholesale component of the excise tax would have exceeded 12.4¢ per gallon, if it were not capped.[25] If the calculated variable component of the motor fuel excise tax rate exceeds the cap, the State Treasurer is directed to transfer funds, on a monthly basis, from the reserve account to the Highway Fund and the Highway Trust Fund. The amount transferred is the difference between the amount of motor fuel excise tax revenue allocated to each of those funds for a month and the amount that would have been allocated to it if the variable wholesale component were not capped at 12.4¢ per gallon. The total amounts that may be transferred to the Highway Fund and the Highway Trust Fund are limited to $17.6 million and $5.7 million, respectively. Funds remaining in the Reserve for Motor Fuels Tax Ceiling on June 30, 2007 revert to the Savings Reserve Account within the General Fund on that date.

These two sections became effective July 1, 2006.

Small Business Health Insurance Tax Credit

Section 24.4 of the act creates a new tax credit for small businesses that provide health benefits to their eligible employees. A 'small business' is defined as a taxpayer that employs no more than 25 full-time employees. An 'eligible employee' is one that works a normal workweek of 30 or more hours. In order to be eligible for the credit, either (1) the business must pay at least 50% of the premiums for health insurance coverage that equals or exceeds the minimum provisions of the basic health care plan of coverage recommended by the Small Employer Carrier Committee, or (2) the employee has existing coverage under one or more of the following: Medicare; Medicaid; a government funded program; or a health insurance or benefit arrangement that provides benefits similar to or in excess of benefits provided under the basic health care plan.

The credit amount is equal to $250 per employee whose total wages or salary received from the business does not exceed $40,000 annually, not to exceed the taxpayer's cost of providing

[25] The amount allocated to the environmental funds is not affected because that amount depends on the number of gallons sold.

the health insurance benefit. The taxpayer may use the credit against either its income tax or its franchise tax liability. The credit may not exceed 50% of the taxpayer's tax liability. Any unused portions of the credit may be carried forward for five years. The credit is effective for taxable years beginning on or after January 1, 2007, and it expires for taxable years beginning on or after January 1, 2009.

Under the Internal Revenue Code, an employer may deduct premiums paid for health insurance cost of its employees as a business expense. This credit would be in addition to any expense deduction the taxpayer claimed on its income tax return for health insurance costs.

Expand Definition of Development Zone

Section 24.5 of the act expands the definition of a development zone to include an economic development and training district. Location in a development zone leads to more favorable treatment for the taxpayer under the Bill Lee Act with respect to the wage standard, the credit for creating new jobs, the credit for investing in machinery and equipment, and the credit for worker training and could result in extending the availability of the credits if certain other criteria are met with respect to a project. The effective date of this change is retroactive for taxable years beginning on or after January 1, 2004.

The General Assembly provided for the creation of economic development and training districts in 2003.[26] An economic development and training district may be created for the purpose of providing a skills training center to prepare county residents to perform manufacturing, research and development, and related service and support jobs in the pharmaceutical, biotech, life science, chemical, telecommunications, and electronics industries. A county may levy property taxes within a district, in addition to those levied throughout the county, in order to finance the skills training center. A municipality cannot annex property within a district. The 2003 legislation provided that if the Board of Commissioners of Johnston County elected to establish an economic development and training district, then the district as initially established would consist of certain described real property owned by Bayer Corporation, Novo Nordisk Pharmaceutical Industries, Inc., Fresenius Kabi Clayton, L.P., and the Johnston County Airport Authority. The Johnston County commissioners created such a district.

The companies expanding in that economic development and training district understood they would be eligible for the Bill Lee tax credits applicable to a development zone. In retrospect, the property included in the district did not meet the requirements of a development zone. This act expands the definition of a development zone to include this property.

Extend Sunsets on Sales and Use Tax Refunds for Aviation Fuel

Section 24.6 of the act extends the sunset for refunds of the State sales and use tax on fuel used by interstate passenger air carriers and on aviation fuel used by a professional motorsports racing team or a motorsports sanctioning body from January 1, 2007, to January 1, 2009. This section became effective when the Governor signed it into law on July 10, 2006. The extension of the sunset is expected to reduce General Fund revenues by $90,000 in fiscal year 2006-2007.

In 2005, the General Assembly added a new refund allowable to interstate passenger air carriers for the net amount of sales and use tax paid by them on fuel during a calendar year in excess of $2,500,000. That same year, the General Assembly enacted a refund for motorsports racing teams and motorsports sanctioning bodies of the sales and use tax paid by

[26] S.L. 2003-418.

them on aviation fuel used to travel to/from a motorsports event in this State, to travel to a motorsports event in another state from a location in this State, or to travel to this State from a motorsports event in another state. Those refunds became effective on January 1, 2005, and applied to purchases made on or after that date; they were scheduled to expire for purchases made on or after January 1, 2007. Section 24.6 of the act extends the date of expiration to January 1, 2009.

Ethyl Alcohol Tax Credit

Although the title of this section refers to ethyl alcohol, the credit itself applies to either ethyl alcohol or biodiesel. In 2004, the General Assembly created a credit for constructing renewable fuel production facilities. The credit is equal to 25% of the costs of constructing the facility. The credit may be claimed against income tax or franchise tax, is limited to 50% of the amount of tax liability against which it is claimed, and has a carryforward period of five years. That credit was set to sunset for taxable years beginning on or after January 1, 2008.

Section 24.7 of the act does two things. First, it extends the sunset on the credit for constructing renewable fuel production facilities and a related credit for constructing a renewable fuel dispensing facility until 2011. Second, it creates an enhanced credit if the taxpayer invests at least $400 million in three separate facilities over a five-year period. As with the current credit, the enhanced credit cannot exceed 50% of the amount of tax liability. Unlike the current credit, the enhanced credit may be claimed only against the income tax, but has a carryforward period of 10 years. A taxpayer may not claim both credits with respect to the same facility.

Tax Credit for Biodiesel Producer

Section 24.8 of the act provides for a tax credit for certain biodiesel providers. In order to qualify for the credit, the provider must be a producer of biodiesel[27] (as opposed to an importer) that produces at least 100,000 gallons of biodiesel during the taxable year. The amount of the credit is equal to the per gallon excise tax (currently 29.9 cents per gallon) paid by the producer on the biodiesel. The credit may be claimed against income tax or franchise tax, is limited to 50% of the amount of tax liability against which it is claimed, and has a carryforward period of five years. The credit is repealed for taxable years beginning on or after January 1, 2010.

Research and Development Sales Tax Changes

Mill machinery is taxed at a 1% rate with an $80 cap per article.[28] Research and development equipment is subject to the 7% State and local sales tax rate. Section 24.9 of this act, as amended by Section 12 of S.L. 2006-196, exempts research and development equipment from State and local sales and use tax and imposes a 1% privilege tax with an $80 cap, thus affording this type of equipment the same tax treatment as mill machinery. In order to qualify, the equipment must meet all of the following requirements:

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[27] For the purposes of this provision, biodiesel is liquid fuel derived in whole from agricultural products, animal fats, or wastes of agricultural products or animal fats. This differs from the definition of biodiesel for motor fuels excise tax purposes in that for motor fuel excise tax purposes the fuel may be derived in part from one of those substances.

[28] Prior to January 1, 2006, mill machinery was subject to a 1% State sales tax with an $80 cap per article. Last session, to comply with the uniform rate requirements of the Streamlined Sales and Use Tax Agreement, the General Assembly exempted mill machinery from the sales tax and began imposing a 1% privilege tax with an $80 cap.

- Purchased by a research and development company in the physical, engineering, and life sciences that is included in industry 54171 of NAICS.[29]
- Capitalized by the taxpayer for tax purposes under the Code.
- Used by the taxpayer in the research and development of tangible personal property.
- Would be considered mill machinery if it were purchased by a manufacturing industry and is used in the research and development of tangible personal property manufactured by the industry.

This section becomes effective July 1, 2007.

Sales and Use Tax Refund for Motorsports Racing Teams

Section 24.10 of the act provides a sales and use tax refund for a professional motorsports racing team for purchases of professional motor racing vehicle component parts other than tires or accessories. The amount of the refund is equal to 50% of the sales and use tax paid. This section becomes effective July 1, 2007, and applies to purchases made on or after that date. A professional motorsports racing team is a racing team (1) operated for profit (2) that obtains the majority of its revenue from sponsorship of the racing team and prize money and (3) that competes in at least 66% of the races per season sponsored by a motorsports sanctioning body. In 2005, the General Assembly enacted a refund for motorsports racing teams[30] and motorsports sanctioning bodies of the sales and use tax paid by them on aviation fuel used to travel to or from a motorsports event in this State, to travel to a motorsports event in another state from a location in this State, or to travel to this State from a motorsports event in another state.

Joint Filing Options

Prior to this act, a married couple who filed a federal joint return was required to file a North Carolina joint return if each spouse was either a resident or had North Carolina income. If one spouse was a nonresident and had no North Carolina income, that spouse was not subject to North Carolina income tax and the other spouse was required to file a separate return. This requirement is based on the fact that North Carolina has no jurisdiction to tax a person who is not a resident and does not have income from North Carolina sources. However, this approach can be burdensome and complicated because the couple must recompute their income separately in order to file a North Carolina return.

Section 24.11 of the act, which originated as a Revenue Laws recommendation[31] provides a married couple with the option of filing jointly if they file a federal joint return and if one spouse is a nonresident with no income from North Carolina. Because North Carolina does not have jurisdiction over the nonresident spouse, the act permits, but does not require, a joint return.[32] This option would also allow North Carolina residents to file jointly in Georgia and South

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[29] 'NAICS' is the North American Industrial Classification System. It divides businesses into categories based on the primary activity that occurs at an establishment.

[30] Section 24.6 of this act inserts the defined term 'professional motorsports racing team' in the refund provisions for aviation fuel.

[31] Senate Bill 1552, 2006 Regular Session of the 2005 General Assembly.

[32] A New York court found that a provision, which required married nonresidents to file a joint nonresident tax return in New York if they filed a joint federal return, was unconstitutional. The court explained that the provision exposed a nonresident spouse with no New York connections to civil and criminal liability in New York by virtue of that spouse's signature on the State tax return.

Carolina. Currently, these two states do not allow nonresident joint filing for residents of states that do not allow joint filings for Georgia and South Carolina residents.

This provision is effective for taxable years beginning on or after January 1, 2006.

Parental Savings Trust Fund Tax Deduction

Section 24.12 of the act allows an individual taxpayer to deduct from the taxpayer's taxable income a maximum amount of $750 contributed by the taxpayer to an account in the Parental Savings Trust Fund. A married couple filing jointly may deduct a maximum of $1,500. To qualify for the deduction, the adjusted gross income of the individual taxpayer or married couple filing jointly must not exceed a specified amount.[33] The deduction is effective for taxable years beginning on or after January 1, 2006, and is repealed for taxable years beginning on or after January 1, 2011. For taxable years beginning on or after January 1, 2007, the deduction for an individual taxpayer is increased to a maximum of $2,000 and the deduction for a married couple filing jointly is increased to a maximum of $4,000.[34] The Parental Savings Trust Fund Tax deduction is repealed for taxable years beginning on or after January 1, 2011.

In 1996, the General Assembly established the Parental Savings Trust Fund. The Fund is maintained by the State Education Assistance Authority, a political subdivision of the State, and is administered by the College Foundation of North Carolina as agent of the Authority. The Fund was established to enable qualified parents to save funds to meet the costs of the postsecondary education expenses of eligible students. Anyone may contribute to the Fund. Because the Fund meets the qualifications of a qualified tuition program under Section 529 of the Internal Revenue Code, distributions from the Fund are excludable from taxable income to the extent the distributions are used to pay for qualified higher education expenses.[35] Interest earned on the Fund is also tax exempt. Currently every state offers a state Section 529 plan, and twenty-five states allow for a full or partial income tax deduction for contributions to the state's own plan.

The Parental Savings Trust Fund deduction allowed by Section 24.12 of this act must be added back to taxable income if the amount withdrawn from the Fund was not used to pay for qualified higher education expenses of the designated beneficiary. An exception is made if the withdrawal was made due to the death or permanent disability of the beneficiary.

The Parental Savings Trust Fund deduction is estimated to reduce General Fund revenues by $1 million in fiscal year 2006-2007, and $1.6 million in fiscal year 2007-2008.

Sales Tax on Railroad Cars

Section 24.13(a) of the act provides that when a lease or rental agreement requires periodic payments for a railway car that is leased by a utility company and the railway car would be considered transportation equipment if it were in interstate commerce, the periodic payments are sourced according to the following general sourcing principles set out in G.S. 105-164.4B(a) for sales tax purposes:

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[33] The deduction from taxable income is allowed for taxpayers with adjusted gross income below the following amounts: $60,000 for a single taxpayer, $100,000 for married, filing jointly, $80,000 for head of household, or $50,000 for married, filing separately.

[34] Section 27 of S.L. 2006-198.

[35] Qualified higher education expenses are: (1) tuition fees, books, supplies, equipment required for the enrollment or attendance of a beneficiary at an eligible educational institution, and expenses for special needs services; and (2) room and board costs.

- When a purchaser receives the product at the business location of the seller, the sale is sourced to that business location.
- When the product is delivered to an address specified by the purchaser, the sale is sourced to the location where the purchaser received the product.
- When the delivery address is unknown, the sale is sourced to the first address or location listed below that is known to the seller:
    - The business or home address of the purchaser.
    - The billing address of the purchaser.
    - The address from which tangible personal property was shipped.

Section 24.13.(a) became effective July 1, 2006, and applies to lease or rental payments made on or after that date.

Section 24.13.(b) of the act provides utility companies with the same refund for a portion of sales and uses taxes paid on purchases of railway cars and accessories that is currently available to interstate carriers for those same purchases.[36] The formula for calculating the refund is based on the number of miles that the applicant operated the railway cars in the State as compared to the total miles, both inside and outside the State, multiplied by the purchase price. The product is then multiplied by the tax rate that would have applied if all of the items had been purchased in this State. The formula for calculating the refund and the procedures for claiming the refund are identical to the formula and procedures set out for interstate carriers in the current law. Section 24.13(b) became effective July 1, 2006, and applies to purchases made on or after that date.

Section 24.13 is estimated to reduce General Fund revenue by $370,000 in fiscal year 2006-2007.

During the 2005 Session, the General Assembly increased the sales and use tax rate of railway cars and locomotives from a 3% rate, with a cap of $1,500 per item, to the 7% general rate in order to comply with the Streamlined Sales Tax Agreement. At the same time the General Assembly authorized interstate carriers to receive a refund of a portion of the sales and use taxes paid on purchases of railway cars and locomotives, as well as fuel, lubricants, repair parts, and accessories for these vehicles. Prior to Section 24.13 of this act, utility companies were not considered interstate carriers for purposes of this refund, even though utility companies often purchase railway cars to transport coal used to generate electricity.

Wage Standards – Certain Manufacturers

Section 24.14 of the act alters the definition of 'location' with respect to certain manufacturers for the purpose of meeting the wage standard under the Bill Lee Act. This change is effective retroactively for taxable years beginning on or after January 1, 1996.

A taxpayer is eligible for a credit under the Bill Lee Act only if the jobs provided by the taxpayer meet a wage standard.[37] For the credit for job creation, the average weekly wage of the jobs for which the credit is claimed and the average weekly wage of all jobs at the

[36] G.S. 105-164.14 defines an 'interstate carrier' as a person who is engaged in transporting persons or property in interstate commerce for compensation.

[37] Legislation in 2002 eliminated the wage standard in enterprise tier one and two areas. Because the wage standard for a business located in a development zone is the same as for tier one counties, that legislation also eliminated the wage standard for a development zone area.

location with respect to which the credit is claimed must meet the relevant wage standard. For the other credits, the average weekly wage of all jobs at the location with respect to which the credit is claimed must meet the relevant wage standard. The term 'location' is not defined in the statute, but the Department of Revenue has interpreted 'location' to be synonymous with 'establishment' for the purpose of applying the wage standard.

This section modifies the definition of 'location' with respect to certain manufacturers. For a fiber, yarn, or thread mill that uses a sequential manufacturing process, the term could mean either a single facility or all facilities located within a single county that were part of the sequential manufacturing process. At least one taxpayer that qualifies as a fiber, yarn, or thread mill that uses a sequential process would become eligible for credits under the Bill Lee Act based on this change. American & Efird, located in Gaston County, undertook activities for which it would have been eligible for credits during the 1996 tax year if it had met the wage standard. The company failed to satisfy the wage standard at each individual facility, but would have satisfied the standard if all the facilities were treated as one location. There are no other known taxpayers that will benefit from this change.

Real Property Tax Donation Credit

In 2001, the General Assembly moved to conform North Carolina law to federal law regarding a partnership's eligibility for certain tax credits. Now, North Carolina law states that a dollar amount limitation on a tax credit applies to a partnership as a whole as well as to each individual partner. When this change was made, the General Assembly voted to delay its imposition of the dollar amount limitation on the credit allowed for real property donations. The credit for real property donations is allowed when a person makes a qualified donation of an interest in real property that is useful for public beach access, public access to public waters or trails, fish and wildlife conservation, or other similar land conservation purposes. The credit is equal to 25% of the fair market value of the donated property interest. To be eligible for the credit, the interest in property must be donated 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 Internal Revenue Code. The credit amount may not exceed $250,000. Originally, that delay was set to expire in 2005. In 2004, the time period for that delay was extended by one year. Section 24.15 of the act extends that delay another year until 2007. This act also directs the Revenue Laws Study Committee to study this issue before the 2007 General Assembly.

Agrarian Growth Zones – Bill Lee

Section 24.16 of the act authorizes the creation of agrarian growth (AG) zones and provides for favorable treatment of the zones under the Bill Lee Act. This section is effective for taxable years beginning on or after January 1, 2006, and applies to business activities occurring on or after that date.

An AG zone must satisfy the following conditions: it must be composed of contiguous census tracts or block groups located within a single county that does not have any municipality with a population in excess of 10,000; each census tract or block group in the zone must have more than 20% of its population below the poverty level; the area of the zone, less its smallest census tract, may not exceed 5% of the total area of the county. The Department of Commerce must designate an area as an AG zone upon the request of a local government.

For the most part, the benefits of an AG zone are the same as the benefits of a development zone. For activities that are performed in an AG zone, the taxpayer does not have to meet the wage standard requirement, receives an additional credit of $4,000 per job created, and is

treated as an enterprise tier one area for purposes of the credit for investing in machinery and equipment and the credit for worker training. There are several provisions of the Bill Lee Act which refer to development zones that were put into place for specific projects; those provisions are not repeated for AG zones. [38]

Internet Data Center Facilities – Tax Exemption

Section 24.17 of the act provides an exemption from the sales and use tax on sales of tangible personal property and electricity to an eligible Internet data center. The section is effective for sales made on or after October 1, 2006.[39]

Generally, sales of tangible personal property are taxed at a State rate of 4.5% and the applicable county rate (generally 2.5%, but 3.0% in Mecklenburg County). Sales of electricity are taxed at rates varying from 0.17% to 3.0% depending on the purchaser of the electricity. Sales of electricity to an Internet data center would be taxed at 3.0%.

This section allows for an exemption from the sales and use tax for sales of electricity and eligible business property to an eligible Internet data center. For the purposes of this exemption, 'eligible business property' is property that is capitalized for tax purposes under the Internal Revenue Code and is used for one or more of the following:

- The provision of Internet service or Web search portal services, including equipment cooling systems for managing the performance of the property.
- The generation, transformation, transmission, distribution, or management of electricity.
- To support related computer engineering or computer science research.

In order to qualify as an eligible Internet data center, a facility must satisfy each of the following conditions:

- The facility is used primarily by a business engaged in Internet service providers and Web search portals industry 51811 as defined by NAICS.[40] Under NAICS, establishments in this industry provide clients access to the Internet or operate Web sites that use a search engine to provide Internet search services. These establishments generally provide related services such as Web hosting, Web page design, and additional Internet services such as email, connections to other Web sites, auctions, news, and other limited content.
- The facility is comprised of a structure or series of structures on a single parcel of land or on contiguous parcels of land owned by the operator of the facility.

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[38] AG zones are included in the replacement of the Bill Lee Act but the incentives offered under it differ from the incentives available under the current Bill Lee Act. The replacement of the Bill Lee Act becomes effective for taxable years beginning on or after January 1, 2007. See the summary of S.L. 2006-252 for an explanation of how AG zones will be treated under the new law.

[39] S.L. 2006-168 made technical changes to this section of the act.

[40] NAICS is the North American Industrial Classification System and divides businesses into categories based on the primary activity that occurs at an establishment.

- The facility is located in an enterprise tier one, two, or three area at the time of the application for the required determination by the Department of Commerce.[41]
- The Department of Commerce has made a written determination that at least $250 million in private funds has been or will be invested in real property, eligible business property, or both at the facility within five years after the commencement of construction of the facility.

A taxpayer that fails to make the level of investment required for qualification forfeits the exemption and is required to repay all taxes, with interest, avoided as a result of the forfeited exemption. Similarly, a taxpayer that does satisfy the investment amount, but fails to use the property or electricity at the eligible facility forfeits the exemption with respect to that particular property or electricity. The past taxes and interest are due 30 days after the date of the forfeiture.

Oyster Shell Tax Credit

Currently, there is a voluntary oyster shell donation program operated by the Division of Marine Fisheries of the Department of Environment and Natural Resources. The Division of Marine Fisheries purchases oyster shells in very large quantities from shucking houses at a negotiated price of 50¢ per bushel. Recycled oyster shells offer the following value: (1) their placement in sanctuaries and/or estuaries aid in the restoration of oyster populations; (2) landscaping purposes; and (3) nutritional supplements. Beginning October 1, 2009, oyster shells may not be disposed in landfills.

Section 24.18 of the act provides for a nonrefundable income tax credit of one dollar for each bushel[42] of oyster shells that a taxpayer donates to the Division of Marine Fisheries of the Department of Environment and Natural Resources. To be eligible for the credit, the taxpayer must provide the Department of Revenue with documentation, supplied by the Division of Marine Fisheries, verifying the donation and the number of bushels donated. The credit may be carried forward for five years. The taxpayer may not claim a deduction for any oyster shells for which a credit is claimed.

Reduce Sales Tax on Electricity Sold to Manufacturers

Effective for sales made on or after July 1, 2007, Section 24.19 of the act replaces the current sales tax rate of 2.83% on sales of electricity to manufacturing industries and manufacturing plants for use in connection with their operation, with a sales tax rate of 2.6%. As under current law, the reduced rate will be applied to the sales price of electricity that is measured by a separate meter or another separate device.

Under current law, the following sales of electricity are subject to a sales and use tax rate of 2.83%:

- Sales to farmers to be used for any farm purposes other than preparing food, heating dwellings, and other household purposes.

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[41] Effective January 1, 2007, S.L. 2006-252 changes the references to enterprise tiers one, two, or three areas to development tier one and two areas.

[42] The Division of Marine Fisheries has determined that the average weight of a bushel of oyster shells is 55 pounds. The net weight of a load of shells is divided by 55, which provides the number of bushels contained in the load.

- Sales to manufacturing industries and manufacturing plants for use in connection with their operation.
- Sales to commercial laundries or to pressing and dry-cleaning establishments for use in machinery used in the direct performance of their service.

Sales of electricity to an aluminum smelting facility are taxed at the rate of 1%, but this rate expires for sales made on or after October 1, 2007.

No Sales Tax Refund for Alcohol Purchases

Section 24A.1 of the act disallows sales and use tax refunds for purchases of alcoholic beverages, effective July 1, 2006. The impact on General Fund revenues is expected to be negligible. North Carolina has authorized certain sales and use tax refunds if qualifying requirements are met. These refunds are codified in G.S. 105-164.14. This section of the act removes purchases of alcoholic beverages from those purchases that qualify for a refund. An alcoholic beverage is one that contains at least one-half of 1% alcohol by volume, including malt beverages, unfortified wine, fortified wine, spirituous liquor, and mixed beverages.

Franchise Tax Loophole Closing

Section 24A.2 of the act adds language to the revenue statutes to close another franchise tax loophole.[43] Subsection (a) of Section 24A.2 amends the definition of 'corporation', as it applies to the franchise tax statutes, to include a limited liability company[44] (LLC) that elects to be taxed as a C Corporation for federal income tax purposes. The effect of this change is that the corporate franchise tax will apply to these LLCs.[45] Subsection (b) makes conforming changes to the LLC statute, G.S. 105-114.1, to provide that LLCs that do not elect to be taxed as a C Corporation will be considered 'noncorporate LLCs' and will be subject to the attribution rules in this statute for franchise tax purposes. Subsection (c) provides LLCs that elect to be taxed as a C Corporation a nonrefundable credit for the difference between the annual report fee for corporations, which is $20, and the annual report fee for LLCs, which is $200.

The above changes were a recommendation of the Revenue Laws Study Committee and originated as the result of at least one request for a private ruling from a major accounting firm. Based on this request, the Department of Revenue identified another scenario that could result in a corporation's avoidance of paying franchise tax. This scenario would involve a corporation headquartered in North Carolina, but whose parent company is domiciled outside the State. In addition, the parent's only contact with North Carolina is its ownership of the

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[43] The North Carolina franchise tax is among the oldest taxes in North Carolina. It is a tax on S Corporations and C Corporations for the privilege of doing business in the State. The tax rate is $1.50 per $1,000 of value of the greatest of (1) apportioned net book value of the corporation; (2) 55% of appraised value of real and tangible personal property in the State; or (3) total actual investment in tangible property in the State.

[44] A limited liability company is a business entity that is essentially a hybrid of a partnership and a corporation. Like a corporation, an LLC limits the liability of its owners. Like a partnership, an LLC is usually not subject to entity-level taxation.

[45] Section 9 of S.L. 2006-196 makes a conforming change to the definition of 'holding company' to recognize that LLCs do not have voting stock but capital interests. Prior to this change, a holding company was defined as a corporation that receives during its taxable year more than 80% of its gross income from corporations in which it owns more than 50% of the outstanding stock. Section 9 adds language to the definition to include a corporation that receives more than 50% of the outstanding voting capital interests, since the holding company cap was intended to apply to LLCs that elect to be treated as C Corporations.

corporation. This corporation, which already files as a C Corporation for federal tax purposes, could convert to an LLC but make an election to continue being taxed as a C Corporation and avoid franchise tax because the parent has no nexus with this State and thus the 'constructive ownership' attribution rules do not apply.[46]

Previous law provided that an LLC could be disregarded and treated as a division of its parent. The parent company was then considered to own property in this State and therefore had nexus, making it subject to income and franchise tax. The constructive ownership rules, therefore, applied for attributing the LLC's assets to the parent's franchise tax calculation. However, when an LLC elects to be taxed as a C Corporation, nexus is not conferred on the parent, and the attributes of the LLC do not flow to the parent. Prior to this act, companies operating in this State as C Corporations could convert to an LLC, make an election to file as a C Corporation, as they always have, and eliminate their North Carolina franchise tax obligations.

This section is effective for taxable years beginning on or after January 1, 2007. The fiscal impact cannot be determined.

Expansion of Royalty Reporting Option

In 2001, the General Assembly enacted G.S. 105-130.7A to enhance corporate compliance with taxes on trademark income. This statute did not change what was already considered taxable but merely enhanced compliance with the State tax on income generated from using trademarks and added a reporting option to the income tax statute. Specifically, G.S. 105-130.7A restates that a company's receipts from royalty payments for the use of trademarks in North Carolina are income from doing business in North Carolina. It provides adjustments to assure full and fair accountability of this income in relationship to where it is actually earned. In cases where the recipient of the North Carolina royalty income is unrelated to the payer, the recipient is required to pay tax on the income to North Carolina. In cases where the recipient and the payer are related, they have an option on how the income is reported to North Carolina. Either the payer can deduct the North Carolina royalty payments on its North Carolina return and the recipient can include them on its North Carolina return, or the payer can add them to its North Carolina income and the recipient can deduct them on its North Carolina return.

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[46] Under current law, the franchise tax extends to all LLC assets that a corporation controls through trusts and other entities, with some limitation. Specifically, a corporation (or an affiliated group of corporations) must own more than 50% of the capital interest in an LLC for the attribution rules to apply, and LLCs whose assets do not exceed $150,000 are exempt. The concept of control is determined by tracing ownership of the capital interests in the LLCs assets. A capital interest is the right to receive some or all of the assets under the LLC's governing law if the LLC was dissolved. Ownership of the capital interests in an LLC is traced, using the principles of constructive ownership, through any noncorporate entities. The chain of constructive ownership can run through layers of noncorporate entities but not through individuals. The franchise tax is payable by corporation or affiliated group of corporations to which ownership of the capital interests is traced. Ownership of capital interests in an LLC is determined as of the last day of the LLC's tax year. If an LLC and a corporation engage in a pattern of trading assets back and forth so that neither owns them on the respective trigger date, the Secretary may require the determination to be made as of the last day of the corporation's tax year. If the capital interests in an LLC are owned by an affiliated group of corporations, the value of the assets is allocated among the members of the group for franchise tax purposes so that there will not be double taxation of any assets. The allocation is in proportion to each affiliate's ownership interest.

This provision solved the problem as it relates to trademarks and trade names, but it did not address other types of intellectual property, such as patents[47] and copyrights.[48] Section 24A.3 of the act expands the royalty payment reporting option for corporations and their related members to include payments received for use of patents and copyrights. As with the changes that occurred in 2001, this provision does not subject any income to tax that was not already taxable, it gives taxpayers an option of how to pay the tax. This provision is effective for taxable years beginning on or after January 1, 2006.

FRANCHISE TAX BASE CALCULATION.

Session Law	*Bill #*	*Sponsor*
S.L. 2006-95	**SB 1283**	**Senator Hartsell**

AN ACT TO CLARIFY THE TREATMENT OF DEFERRED TAX ASSETS IN THE COMPUTATION OF THE FRANCHISE TAX CAPITAL BASE AND TO INCREASE THE ADMINISTRATIVE EFFICIENCY OF THE UNIVERSITY OF NORTH CAROLINA BY EXEMPTING IT FROM LAWS GOVERNING CONSULTANT SERVICES, ALLOWING THE BOARD OF GOVERNORS TO DELEGATE MORE AUTHORITY TO THE PRESIDENT OF THE UNIVERSITY OF NORTH CAROLINA, AND CHANGING ITS REPORTING DATES.

OVERVIEW: This act seeks to clarify the treatment of deferred tax assets in the computation of the franchise tax capital base. It also increases the efficiency of The University of North Carolina by exempting it from laws relating to consultant services and allowing the Board of Governors to delegate more authority to the President of The University of North Carolina.

FISCAL IMPACT: Discussions with the Department of Revenue indicate that the impact of this act will be minimal.
(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2006 Session. Available in the Legislative Library.)

EFFECTIVE DATE: This act became effective when signed into law by the Governor on July 10, 2006. The portions of this act relating to the franchise are effective for taxable years beginning on or after January 1, 2007.

ANALYSIS: The act clarifies the franchise tax base calculation, based upon a recommendation of the Revenue Laws Study Committee. The act also seeks to increase the administrative efficiency of The University of North Carolina, at the request of the University system.

Franchise Tax Base Calculation

A corporation's determination of its capital base for purposes of the franchise tax is not the same as the calculation of its capital base for financial reporting purposes. Most public corporations compute their capital base for financial reporting purposes. Public corporations must comply with the requirements of the Financial Accounting Standards Board (FASB) when

[47] A patent for an invention is the grant of a property right to the inventor that gives the inventor the right to exclude others from making, using, offering for sale, selling or importing the invention for a specified period of time.
[48] Copyright is a form of protection provided under federal law to the authors of original works of authorship, including literary, dramatic, musical, artistic, and certain other intellectual works, both published and unpublished.

reporting the results of their operations and financial positions. Under FASB, corporations are required to accrue certain liabilities and the related deferred tax assets[49] which are applicable to those accrued liabilities in order to accurately reflect the financial position of the corporation.

The calculation of a corporation's capital base for franchise tax purposes is determined by G.S. 105-122(b), not by the requirements of FASB. The statute refers to book value as 'issued and outstanding capital stock, surplus, and undivided profits'[50] This is similar to net book value, which is used in computing the capital base under FASB, with certain adjustments. The principal adjustment is for contingent or deferred liabilities.

Under FASB, deferred tax liabilities are recognized as liabilities for accounting purposes. However, deferred liabilities are not recognized for franchise tax purposes because they are not 'definite and accrued'. Therefore, deferred tax liabilities must be added back to a corporation's capital base for franchise tax purposes.

Frequently, a taxpayer that has a deferred liability will also have a deferred tax asset. The issue is whether the deferred liability that must be added-back can be reduced by the amount of the deferred tax asset. In 1996, the Department of Revenue issued a TAM (technical advice memorandum) that permitted the netting of deferred liability accounts and deferred tax asset accounts. The TAM provided that the deferred tax asset account had to be clearly identified with the deferred tax liability account and the deferred tax asset could not reduce the related deferred liability below zero.

The statute, the 1996 TAM, and generally accepted accounting principles differ on how to account for deferred tax assets as follows:

- The franchise tax statute began the calculation of a corporation's franchise tax capital base with the 'total amount of its issued stock, surplus, and undivided profit'. The statute provided that "no reservation or allocation from surplus or undivided profits shall be allowed other than for definite and accrued legal liabilities, except as herein provided: taxes accrued, dividends declared and reserves for depreciation of tangible assets as permitted for income tax purposes shall be treated as deductible liabilities."
- In 1992, FASB Statement No. 109 established financial accounting and reporting standards for the effects of income taxes that result from an enterprise's activities during the current and preceding years. The statement resulted in deferred tax assets being separately stated from deferred tax liabilities. When the two accounts were netted, a smaller net tax liability account was added back to the franchise tax base. When the accounts had to be separately stated, the Department did not permit the netting of the two accounts. This resulted in the add-back of the deferred tax liability unreduced by the amount of the deferred tax asset.

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[49] Deferred tax assets and deferred tax liabilities are accounts carried on the books of a corporation for financial reporting purposes. They represent timing differences in the recognition of income and deductions for income tax purposes and for financial accounting purposes. Deferred tax liability typically arises where income has been recognized on the corporation's books but not for tax purposes. For example, where a gain is reflected on the books but reported for tax purposes on the installment basis.

[50] In addition, for franchise tax purposes, the corporation's capital base may not be less than 55% of the appraised value of all the real and tangible personal property owned by the corporation in the State nor less than its total actual investment in tangible property in the State.

- Taxpayers having deferred tax asset accounts contended that they should be allowed to reduce their capital stock bases by the balances in those accounts. Since the asset and liability accounts are reciprocal concepts, they argued that it was inequitable to include a deferred tax liability in the capital stock base without decreasing it by the deferred tax asset.
- The TAM appears to contradict the plain meaning of the statute because it permits the deferred liability accounts to be reduced by deferred tax asset accounts.[51] In explaining the change, the TAM states that a more equitable and consistent position is to recognize that net worth is incorrectly stated when the total amount of a deferred liability is included without a netting adjustment for the deferred tax benefit resulting directly from such liability. The TAM provides that the inclusion of a deferred liability in the computation of the net worth base should permit an offset or adjustment for the deferred tax asset required to be computed under the accounting standards without regard to how the deferred tax asset is reflected on the financial statement.

The FASB change in 1992 concerned the accounting for income taxes. Arguably, the TAM written in 1996 attempted to address the accounting changes precipitated by that FASB change. The wording of the TAM, however, refers to deferred liabilities as a whole instead of just deferred tax liabilities. Any deferred liability may create a corresponding deferred tax asset. Taxpayers contend that the TAM permits them to reduce the amount of any deferred liability required to be added back to its net book value for franchise tax purposes by the amount of a deferred tax asset. Examples of the types of contingent and deferred liabilities that have been reduced include post retirement benefits, loan loss reserves, credit card reserves, and litigation reserves.

This act changes the law to allow deferred tax liabilities to be reduced by their corresponding deferred tax assets. This clarification adopts the policy of the Department of Revenue set out in the TAM in 1996.

Increase Administrative Efficiency of The University of North Carolina

The changes in this part of the act do the following:

- Exempt The University of North Carolina from the statutes governing contracts for consultant services. The Board of Governors will now be required to establish its own rules governing these contracts.
- Allow the Board of Governors to delegate more authority to the President of The University of North Carolina.
- Change the reporting date of several studies that must be submitted to the Joint Legislative Oversight Committee from March 1 to December 1.

DELINQUENT PROPERTY TAX/INVENTORY/STUDY.

Session Law	*Bill #*	*Sponsor*
S.L. 2006-106	**SB 1451**	**Senator Hartsell**

[51] In response to taxpayer concerns, the Department of Revenue issued TAM-CF-96-1 in August of 1996. The TAM became effective for tax years ending on or after July 1, 1996.

AN ACT TO ENFORCE COLLECTION OF PROPERTY TAXES ON REAL PROPERTY AGAINST THE RECORD OWNER AS OF THE DATE THE TAXES BECOME DELINQUENT, TO CODIFY THE PRORATION OF TAXES ON REAL PROPERTY, TO REQUIRE A TAX COLLECTOR TO TAKE REASONABLE ADDITIONAL STEPS TO NOTIFY A PROPERTY OWNER OF A TAX SALE UNLESS THE TAX COLLECTOR HAS AFFIRMATIVE KNOWLEDGE THAT THE MAILED NOTICE REACHED THE RECIPIENT, TO AMEND THE DEFINITION OF INVENTORIES TO INCLUDE DISPLAY MODULAR HOMES, AND TO STUDY THE VALUATION OF PROPERTY AT ITS PRESENT-USE VALUE FOR PROPERTY TAX PURPOSES.

OVERVIEW: This act, part of which was a recommendation of the Revenue Laws Study Committee, makes several changes to the property tax laws to facilitate the collection of delinquent property taxes, to provide a standard for prorating property taxes in real estate closings, and to clarify that certain modular homes qualify as inventory and are, therefore, not subject to tax as real estate. In addition, this act directs the Revenue Laws Study Committee to study issues related to the present-use value property tax system.

FISCAL IMPACT: The act is expected to have minimal to no impact on local revenues and no impact on State revenues.
(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2006 Session. Available in the Legislative Library.)

EFFECTIVE DATE: In general, this act is effective for taxes imposed for taxable years beginning on or after July 1, 2006, except that Section 7 of this act is effective for contracts entered into on or after October 1, 2006, and Section 9 of this act became effective when signed into law by the Governor on July 12, 2006.

ANALYSIS: Under North Carolina property tax laws, January 1 is the applicable date for each of the following events: determination of the value of real property for tax purposes, listing of the property in the name of the owner on that date, and attachment of a tax lien to the real property.

The owner of property as of January 1 generally receives a property tax bill in July or August for property taxes due on the property for the fiscal year that runs from July 1 of the year the property is required to be listed to the following June 30. Taxes become due and payable on September 1, and are payable at face amount if paid before January 6 following the due date. Taxes are delinquent if paid on or after January 6 following the due date and are subject to interest charges.[52] For example, if a taxpayer lists his or her property on January 1, 2006, then taxes on the property become due on September 1, 2006, for the fiscal year beginning July 1, 2006, and ending June 30, 2007. Taxes on the property are delinquent beginning January 6, 2007.[53]

In February of each year, the tax collector must report to the governing body the total amount of unpaid taxes for the current fiscal year that are liens on real property. After the governing body orders the tax collector to advertise tax liens, the tax collector must send a notice to the

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[52] For the period January 6 to February 1, interest rate accrues at 2%. For the period February 1 until the date the principal amount of taxes, the accrued interest, and any penalties are paid, interest accrues at the rate of ¾% a month or fraction thereof.

[53] When real property is acquired after January 1, but prior to July 1, and the property was not subject to taxation on January 1 on account of its exempt status, it is listed for tax by the transferee as of the date of acquisition and is appraised at its true value as of January 1 preceding the date of acquisition. The property is taxed for the fiscal year of the taxing unit beginning on July 1 of the year in which it is acquired.

record owner of each affected parcel as determined as of December 31 of the fiscal year for which taxes are due. If the property was transferred during the one-year period beginning on the listing date preceding the fiscal year in which the taxes become due, then the notice of tax lien on the property must be sent to each listing owner and to each record owner of the parcel as determined as of December 31 of the fiscal year for which taxes are due. The notice must inform the owners that their names will appear in a newspaper advertisement of delinquent taxes if the taxes are not paid before the publication date. If the listing owner transferred the property after the listing date, the advertisement will state the record owner's name followed by a notation that the property was transferred to the record owner and a notation of the name of the listing owner.

In addition to the remedy of foreclosing on the real property, the taxing unit may also attach and garnish the wages and other compensation, rents, bank deposits, and other intangible personal property of the listing owner of the property. Attachment and garnishment may only be enforced against the listing owner because the pertinent statutes provide that the remedy may be enforced against the taxpayer. Taxpayer is defined in G.S. 105-273(17) as the person whose property is subject to property tax by a county or municipality and any person who has a duty to list property for taxation.

Section 1 of the act amends the definition of 'taxpayer' in the property tax laws so that for purposes of collecting delinquent property taxes assessed on real property, the remedies against personal property may be enforced only against the record owner of the real property on the date the taxes become delinquent and against any subsequent record owner of the real property if conveyed after the delinquent date. This change means that the tax collector would have the authority to garnish the wages, bank account, or other intangible property of the owner of the property at the time the taxes on that property become delinquent and any subsequent record owner instead of the listing owner of the property.

Section 2 of the act provides that the notice of the tax lien be sent to the record owner of the real property as of the date the taxes became delinquent instead of the listing owner. The advertisement of the tax lien would not set out the name of the listing owner, unless the listing owner and owner of record on the delinquent date is the same person.

Sections 3 and 4 of the act make conforming changes to the statutes regarding the change in definition of 'taxpayer' for collection purposes.

Sections 5 and 6 of the act add language to the notice requirements for a tax lien foreclosure and execution sale of property in order to comply with the notice requirements of *Jones v. Flowers,* decided by the U.S. Supreme Court in April, 2006. In that case, mailed notice of a tax sale was returned unclaimed. The Government then published a notice of public sale in the newspaper. The U.S. Supreme Court held that when the government becomes aware prior to selling the property that its notice attempt has failed, then it must take additional reasonable steps to attempt to provide notice to the property owner before selling his property, if it is practicable to do so. The Court suggested that the Government could have mailed the notice by regular mail or posted notice on the property. Sections 5 and 6 of this act require the tax collector to take additional reasonable steps to notify a taxpayer of a pending tax lien foreclosure if the tax collector is aware that the previous notice attempt failed.

Section 7 of the act codifies the practice of prorating property taxes between the seller and buyer of real property on a calendar-year basis, unless the contract states otherwise. It has become common practice in real estate closings to prorate taxes on a calendar year basis

rather than a fiscal year basis despite the fact that the taxes are imposed on a fiscal year basis.

Section 8 of the act amends the definition of inventory to include a modular home that is used exclusively as a display model and held for eventual sale at the retail merchant's place of business. 'Modular home' is defined as a factory-built structure that is designed to be used as a dwelling, is manufactured in accordance with the specifications for modular homes under the North Carolina State Residential Building Code, and bears a seal or label issued by the Department of Insurance pursuant to G.S. 143-139.1. This language clarifies that a modular home satisfying the proposed language will be classified as inventory and not taxed as real property.

Section 9 of the act directs the Revenue Laws Study Committee to study the present-use value system. Specifically, this section directs the Committee to study the issue of adding new types of property to the present-use value system and adding additional requirements relating to sound management for property enrolled in the present-use value system.

VIDEO SERVICE COMPETITION ACT.

Session Law	*Bill #*	*Sponsor*
S.L. 2006-151	**HB 2047**	**Rep. Carney, Luebke, McComas, Wainwright**

AN ACT TO PROMOTE CONSUMER CHOICE IN VIDEO SERVICE PROVIDERS AND TO ESTABLISH UNIFORM TAXES FOR VIDEO PROGRAMMING SERVICES.

OVERVIEW: This act, which was a recommendation of the Revenue Laws Study Committee, provides for equal taxation of video programming services regardless of how the service is delivered and it replaces locally negotiated franchises of cable service provided over a cable system with a State-issued franchise.

FISCAL IMPACT: This legislation does not change the amount of tax assessed on telecommunications, cable, or satellite television services. All these services remain subject to the sales tax at the combined general rate, which is currently 7%. However, this act significantly alters the calculation of the local share of shared sales tax and creates an entirely new distribution method for the local share of shared sales tax collections.
(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2006 Session. Available in the Legislative Library.)

EFFECTIVE DATE: This act becomes effective January 1, 2007.

ANALYSIS: North Carolina began taxing communication services when the technologies enabling the services were separate and distinct technologies and the providers of the services were separate and distinct taxpayers. Over the past several years, the technology used to provide these services has converged so that the line between the services is no longer separate and distinct. The Current Operations and Capital Improvements Appropriations Act of 2005 directed the Revenue Laws Study Committee to study the equity of taxation of providers of cable service, direct-to-home satellite service, satellite digital audio radio service, video programming service, and data service.

The Revenue Laws Study Committee spent a considerable amount of time on this issue.[54] The Committee found that the State taxes these services based upon who provides the service rather than the service itself. Despite the General Assembly's repeated attempts to provide tax equity among these providers, it is debatable whether that has been accomplished. Prior to this act, the following describes how the State taxed various types of communications.

- The State imposes a 7% State sales tax on telecommunication services and it earmarks a percentage of the revenues to cities. The amount each city receives is based upon a per capita statutory formula. State law prohibits counties and cities from imposing local taxes on this service.
- The State imposes a 7% State sales tax on direct-to-home satellite service. Federal law prohibits a local tax on this service and it prohibits local regulation of this service. The tax revenue is not shared with local governments.
- The State imposes a 4.5% State sales tax and a 2.5% local sales tax on digital audio radio service.
- The State imposes a 7% State sales tax on cable service, with a credit equal to the amount of local franchise tax paid on the service. Counties and cities may impose a local franchise tax on this service; the tax may not exceed 5% of gross receipts. Cable service has been subject to local regulation since 1973. The local regulation of cable service varies from county to county and from city to city, depending on the terms of the locally negotiated agreements. The definition of 'gross receipts' may also vary from agreement to agreement. The cable boxes rented to customers are subject to the State and local sales tax. The gross receipts from the rental of these boxes may also be included in the company's gross receipts for local franchise tax purposes, depending upon how the term is defined in the local agreement.

The Revenue Laws Study Committee acknowledged that the method of taxation should not provide one provider of a service with a competitive advantage over another. The Committee expressed a goal to establish a method of taxation that applies equally to the same service, regardless of who provides it, based on the following principles:

- Equal taxation of the same service.
- A tax system that is easy to administer.
- A tax and regulatory system that does not impede competition.
- Equal compensation to cities for the use of their public rights-of-way.
- Support of PEG (Public access, Education, and Government) channels as a public purpose.

Based upon those principles, it desired a bill that met the following goals:

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[54] The Revenue Laws Study Committee staff met separately with representatives of the cable industry, the telephone industry, the cable administrators, and the counties and cities. It also held a series of four meetings with all the affected parties and solicited comments from the parties on numerous occasions. The staff prepared a survey given to all the local governments in the State to determine their franchise fee collections and other nonmonetary contributions received in accordance with their cable franchise agreements.

- Applies the principles stated above.
- Contains no tax or fee increase.
- Preserves local government revenue streams.
- Promotes competition in the marketplace.
- Promotes deployment of broadband as a basic communication tool.

North Carolina is not alone in grappling with the issue of how to tax and regulate telecommunications and video programming services. Congress and other states are considering legislation on this issue. At this time, at least four states have enacted legislation changing the regulation and taxation of telecommunications and video programming services and at least eight other states have legislation pending on the issue.

This act establishes uniform taxes for video programming services and seeks to promote consumer choice. It establishes equal taxation of the same service by applying a State sales tax at the combined general rate to all video programming services, repealing the local authority to impose a local franchise tax, and repealing the sales tax credit allowed to cable companies for local franchise tax paid. It preserves the local government revenue stream by distributing part of the sales tax revenues from telecommunications and video programming services to the counties and cities. The distribution formula is based upon the amount of cable franchise tax imposed during the first six months of fiscal year 2006-2007 plus any subscriber fees imposed during that same period.

The act promotes competition by providing a State franchise process, in lieu of the current locally negotiated franchise agreements. It seeks to ensure competitive neutrality by allowing cable providers to opt-out of existing local agreements when one or more households in the franchise area may be served by both the existing provider and the holder of a State-issued franchise. The act specifically prohibits discrimination in the provision of video programming services and declares a violation of this law to be an unfair or deceptive trade practice. The holder of a State-issued franchise must comply with customer service and emergency alert requirements established by the Federal Communications Commission. The act designates the Consumer Protection Division of the Attorney General's Office as the State agency to receive customer complaints regarding video programming services.

The act preserves local regulation of public rights-of-way and provides for PEG channel support and growth. The act requires local governments that imposed subscriber fees to use a portion of the amount of revenue distributed to it for PEG channel operation and support and it requires local governments that appropriated money for PEG channels in fiscal year 2005-2006 to continue appropriating that amount of money for PEG channel support. In addition to this mandated funding, the act provides $2 million for supplemental PEG support through direct appropriation for PEG channel support and operation and through grants. The act provides that existing franchise agreements will determine the number, service tier placement, and transmission quality required of PEG channels under a State-issued franchise. In the absence of an existing agreement, the number of PEG channels a county or city may have is determined by the area's population. A local entity may acquire additional PEG channels, with the maximum number of channels set at seven. The act also requires cable service providers to provide free basic service to local public buildings.

State issued franchise. – Section 1 of the act replaces the authorization to counties and cities to award a franchise for cable service with a State franchising authority, effective January 1,

2007. The act provides that a county or city may not award or renew a franchise for cable service after this date. The act designates the Secretary of State as the exclusive franchising authority in the State for cable service provided over a cable system. The terms 'cable service' and 'cable system' track the definitions in federal law. The act requires the franchising of cable service that is required to be franchised under federal law. The act does not expand the services that need to be franchised beyond those currently required to be franchised under federal law.

The State franchise process is one of notice, not regulation. To receive a State-issued franchise, a person must file a notice of franchise with the Secretary of State and pay a fee of $125.[55] A person who files a notice of franchise with the Secretary must begin providing cable service within 120 days after the notice is filed. If service is not provided within this period, the notice of franchise terminates 130 days after it was filed. The notice of franchise must include all of the following:

- The applicant's name, principal place of business, mailing address, physical address, telephone number, and e-mail address.
- A description and map of the area to be served.
- A list of each county and city in which the described service area is located.
- A schedule indicating when service is expected to be offered in the service area.

Notice of Service. – Once cable service is provided, the holder of a State-issued franchise must file a notice of service with the Secretary within 10 days after the cable service begins. The notice of service must include the effective date of the notice of franchise for that area, a description and map of the service area, and a statement that cable service has begun in the service area.

Annual Service Report. – The holder of a State-issued franchise must also file an annual service report on or before July 31 of each year and pay a fee of $200.[56] The annual service report must include all of the following:

- The effective date of a notice of franchise for that area.
- A description and map of the service area.
- The approximate number of households in the service area.
- A description and map of the households passed[57] in the service area as of July 1.
- The percentage of households passed in the service area as of July 1.
- The percentage of households passed in the service area as of July 1 of any preceding year for which a report was required.
- A report indicating the extent to which the holder has met the customer service requirements.

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[55] Fee amount is the same as the filing fee for articles of organization of a limited liability company under G.S. 57C-1-22.

[56] Fee amount is the same as the filing fee for an annual report of a limited liability company under G.S. 57C-1-22.

[57] A household is 'passed' if service is available to that household, regardless of whether the household subscribes to the service.

- A schedule indicating when service is expected to be offered in the service area, to the extent the schedule differs from one included in the notice of franchise or in a report previously submitted, and an explanation of the reason for the new schedule.

General filing and reporting requirements. – A person who files a notice of franchise or an annual service report with the Secretary of State must send a copy of the document to any county or city included in the service area described in the document as well as to the registered agent of any cable service provider that is providing cable service under an existing agreement in the service area. The provisions of Article 2 of Chapter 55D of the General Statutes apply to the submission of documents.[58] The Secretary must either post to its Internet Web site the document filed or indicate on its Internet Web site that the document has been filed and is available for inspection.

A person who offers cable service over a cable system without filing a notice of franchise or a notice of service is subject to forfeiture of the revenue received from subscribers to the cable service during the period of noncompliance. A cable service provider whose area includes the area in which a person is providing cable service without complying with the notice requirements may bring a civil action for forfeiture.

Existing agreements. – An existing agreement is defined as a local franchise agreement that is in effect on January 1, 2007, or as one that expired before January 1, 2007, and the cable service provider under the agreement provides cable service to subscribers in the franchise area on January 1, 2007. The State franchising authority does not affect an existing agreement, except as follows:

- Effective January 1, 2007, gross revenue used to calculate the payment of a local franchise tax does not include gross receipts from cable service subject to the State sales tax.
- A local franchise agreement may be terminated in any one of the following circumstances:
    - When a notice of service indicates that one or more households in the franchise area of the existing agreement are passed by both the cable provider under the existing agreement and the holder of a State-issued franchise.
    - As of January 1, 2007, a county or city has an existing agreement with more than one cable service provider and at least 25% of the households in the franchise areas of the existing agreements are passed by more than one cable service provider.
    - A person provides wireline competition in the franchise area of the existing agreement by offering video programming, as defined in G.S. 105-164.3, over wireline facilities by a method that does not require a State-issued franchise. To terminate an existing agreement under this circumstance, a cable service provider must include evidence of the competition. A county or city is allowed 60 days to review the evidence.

[58] This Article contains several provisions: To be filed, a document must contain all the required information and be accompanied by the filing fee. The Secretary of State's filing of a document does not relate to the veracity of the document. A person who knowingly signs a false document filed with the Secretary is guilty of a Class 1 misdemeanor.

The termination becomes effective at the end of this 60-day period unless the county or city brings an action to stay the termination.

Termination of existing agreements. – To terminate an existing agreement, a cable service provider must file a notice of termination with the affected county or city and file a notice of franchise with the Secretary of State. A notice of termination becomes effective at the end of a month. A termination of an existing agreement ends the obligations under the agreement and under any local cable regulatory ordinance as of the effective date of the termination.

Service standards and requirements. – The act specifically prohibits discrimination in the provision of the cable service. A violation of the law is an unfair and deceptive trade practice under G.S. 75-1.1. In determining whether a cable service provider has violated the law, the following factors may be considered: the length of time since the provider filed the notice of service for the area, the cost of providing service to an area, technological impediments to providing service to an area, the inability to obtain access to property required to provide service to an area, and competitive pressure to respond to service offered by another cable provider. The information in the annual service reports may be used to help determine whether a violation of the law has occurred.

A cable service provider must comply with the customer service requirements and emergency alert requirements established by the Federal Communications Commission. The Consumer Protection Division of the Attorney General's Office is designated as the State agency to receive and respond to consumer complaints. In addition to any other authority the Attorney General has to respond to consumer complaints, the act provides that persistent or repeated violations of the federal customer service requirements or the terms and conditions of the cable service provider's agreement with customers is an unfair and deceptive trade practice under G.S. 75-1.1. Each individual violation of the federal requirements or the provider's agreement constitutes a separate violation. In a suit instituted by the Attorney General's office, the court may impose a civil penalty of up to $5,000 a day for each violation if it finds the cable service provider violated G.S. 75-1.1. In a suit instituted by a person where the cable service provider is found to have violated G.S. 75-1.1, the person is entitled to treble the amount of damages fixed by the verdict.

PEG channels. – The act requires a cable service provider operating under a State-issued franchise to include the transmission of PEG channels. A county or city may make a written request for PEG channel capacity and the cable service provider must provide the requested capacity within 120 days after it receives the request. A city with a population of at least 50,000 is allowed a minimum of three PEG channels and a city with a population of less than 50,000 is allowed a minimum of two PEG channels. A county is allowed a minimum of two PEG channels. This minimum number of initial PEG channels may be increased by the number of channels in excess of this minimum that are activated as of July 1, 2006, under the terms of an existing agreement whose franchise area includes the city or county.

The maximum number of PEG channels a cable service provider must provide to a county or city is seven. If a county or city does not have seven PEG channels, including the initial PEG channels, it may request additional channels. The additional channels may be provided on any service tier and the transmission quality of the additional channels must be at least equivalent to the transmission quality of the other channels provided. The PEG channels operated by a county or city must meet the following programming requirements in order for the county or city to obtain additional channels:

- All of the PEG channels must have scheduled programming for at least 8 hours a day.
- The programming content of each PEG channel must not repeat more than 15% of the programming content on any of the other PEG channels.
- No more than 15% of the programming content on any PEG channel may be character-generated programming.[59]

A cable service provider is responsible only for the transmission of a PEG channel. A county or city to which the PEG channel is provided is responsible for the operation and content of the channel.

PEG channel grants. – The act establishes the PEG Channel Fund as an interest-bearing special revenue fund. The purpose of the Fund is to provide matching grants to counties and cities for PEG channel support. The e-NC Authority administers the Fund.[60] A grant may only be used for capital expenditures necessary to provide PEG channels. The size of a grant may not exceed $25,000 and an applicant may receive no more than one grant per fiscal year. The applicant must match the grant on a dollar-for-dollar basis. The Authority must publish an annual report on the grants awarded from the Fund.

Service to public buildings. – At the written request of a county or city, a cable service provider operating under a State-issued franchise must provide cable service without charge to a public building located within 125 feet of the provider's cable system. The required service is the basic, or lowest-priced, service the provider offers to customers. Only one service outlet is required for a building. A public building is a building used as a public school, a charter school, a library, or for a function of the county or city. A cable provider is not required to provide service that conflicts with restrictions that apply in a program licensing agreement or another contract.

State sales tax. – Sections 2 and 3 of the act apply the State sales tax equal to the combined general rate[61] equally to all video programming services, regardless of who provides the service. Section 2 defines the term 'video programming' to be programming provided by, or generally considered comparable to programming provided by, a television broadcast station, regardless of the method of delivery. The term is broader than 'cable service provided over a cable system'. It would include cable services offered over private rights-of-way as well as those offered over public rights-of-way. Section 3 imposes a State sales tax at the combined general rate on the gross receipts derived from providing video programming to a subscriber in this State.[62]

Local distribution. – Sections 7 and 8 of the act distribute a share of the sales tax revenues imposed on video programming to counties and cities. The legislature finds that the revenue

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[59] 'Character-generated programming' is programming that consists of text messages. Examples of character-generated programming include menus and bulletin boards.

[60] The e-NC Authority is charged with managing and promoting high-speed broadband Internet access.

[61] The combined general rate is the State sales tax rate set in G.S. 105-164.4(a) plus the sum of the rates of the local sales and use taxes.

[62] Although the term video programming includes broadcast services, the provision of these services would not be taxed unless the provider sells the service to subscribers and thus realizes gross receipts from the provision of the services.

distributed is local revenue, not a State expenditure. Thus, the Governor may not reduce or withhold the distribution.[63]

Section 7 increases the amount of the sales tax revenue derived from telecommunication services distributed to cities and counties. Section 8 distributes the following portion of the gross receipts derived from video programming to counties and cities: 22.61% of the net proceeds collected on video programming, other than on direct-to-home services and 37% of the net proceeds collected on direct-to-home satellite service.[64] The distributions will be made quarterly.
The amount distributed will be allocated as follows:

- Two million dollars ($2,000,000) a year will be distributed as supplemental PEG channel support. A portion of this amount will be distributed to counties and cities with qualifying PEG channels.[65] The amount per qualifying PEG channel is $25,000. A county or city cannot receive supplemental PEG channel support for more than three PEG channels. The amount distributed to a county or city as supplemental PEG channel support must be used by it for the operation and support of PEG channels. If the amount to be distributed for qualifying PEG channels in a fiscal year is less than $2,000,000, the Secretary must credit the excess amount to the PEG Channel Fund to be used for matching local grants for PEG channel support.

- The remainder of the revenues to be distributed will be allocated between the counties and cities on a proportional basis. The proportionate share of a county or city is the base amount for the county or city compared to the base amount for all counties and cities. The base amount for a county or city that did not impose a cable franchise tax before July 1, 2006, is two dollars ($2) times the most recent annual population estimate for that county or city. The population of the county is the population of its unincorporated areas plus the population of an ineligible city in the county. The base amount for a county or city that imposed a cable franchise tax before July 1, 2006, is the amount of cable franchise tax and subscriber fee revenue the county or city certifies to the Secretary it imposed during the first six months of fiscal year 2006-2007. For subsequent fiscal years, the amount each county or city receives will be adjusted based upon its percentage change in population.

A county or city that imposed subscriber fee revenue must use a portion of the amount distributed to it for PEG channel operation and support. The amount it must use for this purpose is two times the amount of revenue it certified to the Secretary it imposed as subscriber fees during the first six months of fiscal year 2006-2007. A county or city that appropriated funds for PEG channel operation and support during fiscal year 2005-2006 must continue appropriating that amount of funding for PEG channels. The remainder of the money distributed to counties and cities may be used for any public purpose.

Conforming and technical provisions. – Sections 4 through 6 of the act make technical and conforming changes to the provisions governing bundled transactions.

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[63] It is debatable whether a legislative finding that the revenue is a local revenue rather than a State expenditure would be adopted by a court if challenged. However, such a finding is not unprecedented as the legislature enacted several such findings in 2002 after the Governor withheld certain funds generally distributed to local governments.
[64] This percentage distribution from satellite TV services mirrors the 2.5% local sales tax on satellite radio services.
[65] A "qualifying PEG channel' is a channel that meets the programming requirements under G.S. 66-357(d).

Section 9 repeals the credit against the State sales tax on cable services for local franchise tax paid because the local franchise tax is repealed in Section 13.

Section 10 repeals the county's authority to franchise cable television services.

Section 11 repeals the county's authority to impose a franchise tax on cable services. Unlike a city, a county may only levy a privilege tax to the extent it is authorized by law. This section repeals the county's authorization.

Section 12 specifically prohibits a city from imposing a tax on video programming services under the statute that gives cities the general authority to levy a privilege license tax on businesses and franchises unless prohibited from doing so by law. This section contains such a prohibition.

Section 13 repeals the city's specific statutory authority to impose a franchise tax on cable services.

Section 14 clarifies that a city may not impose a fee or charge for use of the public right-of-way unless the fee or charge applies uniformly to all non-municipal users of the public right-of-way.

Section 15 repeals the city's authority to franchise cable television services.

Section 16 requires a county or city desiring to receive a distribution for supplemental PEG channel support under G.S. 105-164.44I(b) to certify to the Secretary of Revenue by March 15, 2007, the number of qualifying PEG channels it operates.

Studies. – Section 17 recognizes that the staffing needs of the Consumer Protection Division of the Attorney General's Office may change with the passage of this act. However, the section also finds that the impact of this act on the staffing needs of the Division is not clear. This section requests the Office of the Attorney General to monitor the number and type of cable service complaints it receives from customers and to determine whether the Division needs additional staff to fulfill the duty imposed by this act on it. The Office of the Attorney General must make a report concerning its staffing needs to the Fiscal Research Division by April 1, 2007.

Section 18 directs the Consumer Protection Division of the Attorney General's Office to report to the Revenue Laws Study Committee on or before April 1 of each year, beginning April 1, 2008, on the number of customer complaints it has received regarding cable service, the types of complaints, and the different means it has used to resolve those complaints.

Section 21 directs the Revenue Laws Study Committee to review the effects of this act on competition in video programming services, the number of cable service subscribers, the price of cable service by service tier, the technology used to deliver the service, and the deployment of broadband in the State. The Committee may recommend any changes to the law it believes are necessary to the North Carolina General Assembly.

Severability. – Section 19 provides that an award of a State-issued franchise does not affect a determination of whether video programming provided by the holder of the franchise is considered cable service provided over a cable system under federal law.

Section 20 provides that the provisions of this act are severable.

REVENUE LAWS TECH. & MOTOR FUEL TAX CHANGES.

Session Law	*Bill #*	*Sponsor*

S.L. 2006-162 **HB 1963** **Representative Luebke**

AN ACT TO MAKE TECHNICAL, CLARIFYING, AND ADMINISTRATIVE CHANGES TO THE REVENUE LAWS AND RELATED STATUTES, TO IMPROVE THE COLLECTION AND ADMINISTRATION OF THE MOTOR FUEL TAX, AND TO AUTHORIZE A COUNTY THAT IMPOSES A SALES TAX FOR PUBLIC TRANSPORTATION TO LEVY A VEHICLE RENTAL TAX.

OVERVIEW: This act makes technical, clarifying, and administrative changes to the revenue laws and related statutes and to the motor fuel tax laws to improve collection and administration. These changes were a recommendation of the Revenue Laws Study Committee. The act also authorizes counties that impose an additional one-half cent sales and use tax for public transit to also levy a vehicle rental tax.

FISCAL IMPACT: Parts I. through IV. of this act have no fiscal impact. Part V. has no fiscal impact on the General Fund, and the impact to local government revenue cannot be determined. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2006 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: Except as otherwise specified, this act became effective when signed into law by the Governor on July 24, 2006.

ANALYSIS:

Part I: Technical Changes.

Section	Explanation
1	Corrects a departmental reference since S.L. 2005-380 transferred the NC Grape Growers Council from the Department of Agriculture and Consumer Services to the Department of Commerce.
2	Removes obsolete language and makes other stylistic changes. This statutory subsection makes two obsolete references to the appraised value of intangible property in the appraised value base. This language became obsolete with the repeal of the intangibles tax effective for tax years beginning on or after January 1, 1995. The Department of Revenue does not require intangible property to be included in the appraised value base.
7	Makes a grammatical change to the statute.
19	Amends the caption of the statute to reflect what the statute actually provides.
21	Corrects an incorrect statutory reference.
22	Corrects an incorrect statutory reference.
23	Corrects introductory language from a 2005 session law.
24	Corrects an incorrect statutory reference within a local session law.
27	Repeals a reporting requirement related to sales and use tax refunds allowed to local school administrative units. This reporting requirement is unnecessary since the General Assembly changed the law in 2005 to redirect State sales and use tax revenues refundable to LEAs to the State Public School Fund.
28	Corrects an incorrect statutory reference.
31	Corrects an incorrect statutory reference.

Part II: Clarifying Changes

Section	Explanation
3(a) & (b)	Defines the term 'gross income' in the corporate income tax law by reference to Section 61 of the Internal Revenue Code, which is the same definition that is currently found in the individual income tax law. Section 3(b) is a conforming change.
5(a) & (b)	In 2005, the General Assembly made the use tax applicable to services sourced to this State. Section 5(a) is a conforming change which amends the definition of 'use' to include services. Section 5(b) is a conforming change to the statute regarding use tax returns.
6	Corrects an inadvertent omission. In the 2005 budget bill, there was a rewrite of this statutory section on use tax. A credit should be allowed for both sales and use tax paid to another state, but the revised statute only provided a credit for sales tax paid. There was no intent to change the application of the tax, so this section adds the phrase 'or use' back into the statute.
8(a) & (b)	Clarifies that the exemption from sales tax for sales of grain, feed, or soybean storage facilities and accessories only applies to sales made to farmers. This was one of the items previously subject to the 1%, $80 maximum rate of tax. The 1% rate was imposed on sales to farmers of grain, feed, or soybean storage facilities and accessories. In 2005, in order to conform to the Streamlined Agreement, the General Assembly exempted these items from sales tax. However, the new exemption did not limit the exemption to farmers.
12	Section 12(a) makes changes to various penalty statutes. Section 12(a) repeals two misdemeanor statutes relating to the willful failure to comply with the tax laws and aiding and abetting in the violation of the tax laws. These violations are covered by G.S. 105-236(9), so the two statutes are unnecessary. Section 12(b) reorganizes the penalties statute and makes some technical and clarifying changes. It divides the former statutory section into three subsections: subsection (a) lists the various penalties available to the Department of Revenue for violations of the tax laws; subsection (b) is a recodification of the principle previously set out in subdivision (11), which states that a violation of a tax law is considered an act committed in part at the office of the Secretary in Raleigh; and subsection (c) restates language previously found at the beginning of the statute directing the disposition of the penalty proceeds to the Civil Penalty and Forfeiture Fund. Subsection (c) also deletes an obsolete requirement to avoid the penalty for a bad check, which states that a person had sufficient funds in a bank account 'in this State'. Since the Department does not follow this requirement, it is deleted. Section 12(c) repeals G.S. 105-449.127, which provides that civil penalties assessed for violation of the motor fuels tax laws be credited to the Highway Fund. Section 12(c) also repeals G.S. 105-449.48, which provides that fees collected for the issuance of temporary permits for motor carriers and all civil penalties collected for violations of the motor carrier laws be credited to the Highway Fund. Section 12(d) moves the fee disposition language in repealed G.S. 105-449.48 to G.S. 105-449.49.

	The repeal of these two statutes redirects from the Highway Fund to the Civil Penalty and Forfeiture Fund any civil penalty proceeds collected under these two statutes as required by *North Carolina School Boards Assn. v. Moore*. In July of 2005, the North Carolina Supreme Court in the above referenced case held that the penalties assessed under Chapter 105 are imposed as a monetary payment for a taxpayer's noncompliance with a mandate of the Revenue Act, that they are punitive in nature, and, as such, they are subject to Article IX, Section 7 of the North Carolina Constitution requiring these funds be remitted to the Civil Penalty and Forfeiture Fund for use by the schools.
18	Amends the caption of G.S. 105-249.2 by replacing the word 'individuals' with the word 'persons'. This statute provides, in part, that no penalties may be assessed for any period in which the time for filing a federal return or for paying a federal tax is extended because of a presidentially declared disaster. The relief provided by this statute is applied by the Department of Revenue equally to all tax entities, including businesses, and not just individuals.
26	Amends the State estate tax statute by clarifying that State estate tax liability may not exceed federal estate tax liability determined without regard to the deduction for State death taxes or certain federal credits. Prior to this act the Department of Revenue interpreted the statute as limiting the State estate tax in this way, but the Estate Planning Section of the NC Bar Association requested that clarifying language be put in the statute. This change does not change the way in which estate tax is calculated.

Part III: Administrative Changes

Section	Explanation
4	Section 4 relates to the new film incentives tax credit enacted in 2005. Subsections (a) and (b) make clarifying changes to the film incentives in both the corporate and individual provisions. First, the term 'highly compensated individual' is limited to individuals who are compensated for services and does not include individuals who may sell goods in excess of the one-million-dollar limitation. Second, the exclusion of amounts paid to highly compensated individuals is clarified so that it is clear that the exclusion applies whether the individual is paid directly by the production company or by an unrelated third-party. It is not uncommon for a production company to contract with a separate entity for the services of actors or other professionals involved in a production. Third, the statutes are amended so that withholdings must be remitted in order for compensation to qualify as a qualifying expense, but that withholding does not necessarily have to be performed by the production company. Subsection (c) makes changes to G.S. 105-259(b) of the confidentiality statute, one of which is related to the film incentives tax credit. It adds a new subdivision (36), which allows the Department of Revenue to provide to a production company claiming a film production credit information used by the Department to adjust the amount of the credit claimed by the production company.

	It also repeals subdivision (32), which allows the Department of Revenue to provide to the Department of Public Instruction and the Fiscal Research Division reports regarding sales and use tax refunds received by school administrative units. This provision was enacted last year. However, Section 32(b) of S.L. 2005-435 amended the definition of tax information to exclude governmental agency refunds. Therefore, an exception is not needed in the confidentiality statute since the information is no longer confidential tax information. It also rewrites subdivision (27) to create a generic exception to allow disclosure of reports required by law rather than listing out specific statutes and makes conforming changes. This section became effective for taxable years beginning on or after January 1, 2006.
9	In 2005, the General Assembly authorized a sales and use tax refund for the purchase of fuel by interstate passenger air carriers and by motor sports racing teams or sanctioning bodies. Under current law, the Department of Revenue is required annually to publish the number of taxpayers claiming certain sales and use tax refunds. This section adds these categories of refunds to the reporting requirement.
10	Clarifies the effective date for a rate increase with regard to prepayments of service. In 2005, the General Assembly enacted G.S. 105-164.15A, which addresses the effective date for rate increases and decreases to taxable services, but the statute does not specifically address prepayments of service.
11	Provides a credit against the privilege tax for sales and use tax, or a similar type of tax, paid to another state. Under prior law, there was no specific provision for credits in the newly enacted Article 5F. *Manufacturing Fuel and Certain Machinery and Equipment*.
20	Section 20(a) and (b) conform the date an occupancy tax return is due to the date that the occupancy taxes are due.
25	Allows a municipality to create a municipal service district effective upon the adoption of the resolution creating it, rather than waiting for the first day of the next fiscal year, if general obligation bonds are anticipated to be authorized for the project. However, it provides that no ad valorem tax may be levied for the partial year.
29	Repeals G.S. 106-452, which sets the maximum charges for handling and selling tobacco on the floor of tobacco warehouses.
32	Conforms the language in G.S. 105-467(b) to changes made by S.L. 2006-33, that exclude ancillary service from the refund of sales and use taxes paid by certain local school administrative units for tangible personal property and services. Effective January 1, 2007

Part IV. Motor Fuel Tax Changes

Section	Explanation
13(a) & (b)	Section 13 gives the Department of Revenue the ability to cross match all motor fuel to ensure compliance with the motor fuel tax laws. Under current law, the Department may cross-match information regarding fuel entering the State and fuel leaving the State, but it cannot cross-match information

	regarding the intrastate movement of motor fuel. The Department has a new fuel tracking system that will better enable it to monitor the movement of fuel. The Department expects the system to be operational by the last quarter of this fiscal year. Section 13 makes the statutory changes necessary to enable the Department to review intrastate movements of fuel by providing that anyone who transports fuel must be licensed as a transporter and that all transporters must file informational returns on all movements of motor fuel. Section 13(a) provides that all people who transport motor fuel will be licensed as a motor fuel transporter. Under current law, a person licensed as a distributor or blender is considered to be licensed as a motor fuel transporter if the person transports the fuel for others for hire. This section removes the exception for persons who transport their own fuel so that any distributor or blender who transports fuel – whether for hire or for their own use – would also be considered licensed as a transporter. Section 13(b) provides that a transporter must file an informational return showing deliveries of motor fuel. Under current law, only interstate movements of fuel must be reported on a monthly informational return. The change in this section of the bill will require such a return for all deliveries of fuel. Section 13 becomes effective July 1, 2007, and applies to motor fuel transported on or after that date.
14	Section 14 provides that all motor fuel leaving the terminal rack is subject to the motor fuel excise tax. The Department requested this change to reduce the areas of evasion and inadvertent duplicate refunds. Under current law, a licensed distributor or importer may remove fuel from a terminal without paying the tax if the person has an exempt card issued by the supplier. This section removes the ability of distributors and importers to use exempt cards at the terminal rack. Instead, they will be able to obtain a monthly refund on any sales of fuel to exempt entities.[66] This change conforms North Carolina's law to the laws of the surrounding states who do not allow untaxed gasoline or undyed fuel to leave their terminals without the imposition of the tax. Section 14(a) puts the definition of 'exempt card or code' in the definitional statute for the motor fuel article. Section 14(b) repeals the portion of the statute that allows fuel to be removed from the terminal without paying the tax. Section 14(c) repeals the requirement of a quarterly return and makes conforming changes. Section 14(d) removes the deduction a licensed distributor or importer may make for tax exempt fuel taken from the terminal rack because the ability to obtain the fuel without paying the tax is repealed in section 14(b). Section 14(e) repeals the statute requiring a licensed distributor or importer who obtains fuel at the terminal rack with an exempt card to file a quarterly reconciling return. Section 14(f) makes

[66] G.S. 105-449.88 exempts the following entities from the motor fuel excise tax if it is sold to them for their use: the federal government, the State, local boards of education, charter schools, community colleges, counties, municipalities, and airports.

	conforming changes. Section 14(g) provides a monthly refund procedure for a distributor who sells diesel fuel to an airport. A refund procedure already exists for sales of motor fuel to the other listed exempt entities. Section 14 becomes effective January 1, 2007, and applies 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.
15	Section 15 establishes a common due date for all motor fuel tax and informational returns. Under current law, most of the monthly tax returns are due on the 22nd day of the month following the month covered by the return. Informational returns are due on the 25th day of the month following the month covered by the return. These sections provide that all monthly returns are due on the 22nd day of the month following the month covered by the return. Section 15 becomes effective January 1, 2007, and applies to motor fuel purchased on or after that date.
16	Section 16 adds a reference to the privilege tax imposed under Article 5F, which was enacted last year, with respect to refunds of motor fuels tax allowed for nonhighway use of a vehicle. A refund of motor fuels tax allowed for the nonhighway use of a vehicle is to be reduced by the amount of sales and use tax owed based on the method set out in G.S. 105-449.107. Prior to January 1, 2006, the amount of sales tax due was based on either the general State and local rates of tax or the 1% rate imposed on sales of fuel to farmers and manufacturers. Effective January 1, 2006, sales of fuel to farmers and manufacturers are subject to the new 1% privilege tax. Currently, these two statutes refer only to the sales and use taxes levied in Article 5.
17	Section 17 removes the misdemeanor for taxpayers failing to pay the destination state taxes collected to that state. This provision was put into the law when North Carolina first moved to tax-at-the-rack. Today, all of the surrounding states have destination state tax laws. North Carolina does not collect and remit the taxes to those states, therefore this misdemeanor is no longer needed. Section 17 becomes effective January 1, 2007, and applies to motor fuel purchased on or after that date.

Part V: Expansion of Tax Authority for Certain Counties.

Section	Explanation
30	Section 30 authorizes a county that imposes an additional ½ cent sales and use tax for public transportation to also levy a vehicle rental tax. In 1997, the General Assembly authorized a regional public transportation authority to levy a gross receipts tax of up to 5% on retailers within the region engaged in the business of renting private passenger vehicles and motorcycles. The tax applies only to short-term rentals which are rentals for a period of less than one year. Each authority may use the proceeds of the tax for its public transportation purposes.

	Section 30 provides that a county that imposes the additional ½ cent sales and use tax is considered an authority under the 1997 legislation and may also levy a vehicle rental tax. The county must allocate the proceeds of any vehicle rental tax it imposes to the largest city in the county that operates a public transportation system. The city must use the money to finance, construct, operate, and maintain local public transportation systems. However, unlike the tax proceeds from a vehicle tax levied by a public transportation authority, the proceeds of a vehicle tax levied by a county may be used to supplant and replace existing general fund revenues allocated for a public transportation system. Under current law, this section applies only to Mecklenburg County, since that county is the only one that imposes an additional ½ cent sales and use tax for public transportation. If the Mecklenburg County Board of Commissioners decides to levy a vehicle rental tax of 5%, then the annual proceeds generated from the tax are estimated to be $7.4 million.

ECONOMIC DEVELOPMENT PROGRAM MODIFICATIONS.

Session Law	*Bill #*	*Sponsor*
S.L. 2006-168	**HB 2744**	**Rep. Owens, Daughtridge**

AN ACT TO MAKE MODIFICATIONS TO THE JOB DEVELOPMENT INVESTMENT GRANT PROGRAM, TO EXTEND THE WILLIAM S. LEE QUALITY JOBS AND BUSINESS EXPANSION ACT FOR CERTAIN TAXPAYERS, AND TO EXTEND CERTAIN SALES AND USE TAX REFUNDS.

OVERVIEW: This act makes numerous changes to the Job Development Investment Grant Program, it extends by two years the time period in which eligible major industries can qualify for the extension of the Bill Lee Act, and adds financial services, securities operations, and related systems development as an industry that is eligible for the sales and use tax refund related to certain building materials.

FISCAL IMPACT: The act could reduce General Fund revenues by as much as $570,000,000 over a 12-year period.
(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2006 Session. Available in the Legislative Library.)

EFFECTIVE DATE: Except as otherwise noted, this act became effective when signed into law by the Governor on July 27, 2006.

ANALYSIS:

Part I: JDIG Changes

The Job Development Investment Grant (JDIG) Program was created in 2002 as a new economic development tool for new and expanding businesses in North Carolina. JDIG is used to attract businesses to the State by allowing a five-member committee to award grants to businesses. The amounts of the grants are based on income tax withholdings from new jobs created by the businesses.

This act makes numerous changes to the JDIG program. Some of these changes significantly expand or extend the program, whereas other changes are intended to streamline the

administration of the program, clarify certain aspects of the program, or reduce penalties for failure to comply with agreements under the program.

There are two changes in the act that may significantly add to the cost of the program over the next 12-13 years. First, the act increases the maximum amount of total annual liability for agreements entered into during the 2006 calendar year from $15 million to $30 million. This change is effective for agreements entered into during 2006 only; for agreements entered into in later years, the maximum amount of the total annual liability returns to $15 million. Under the JDIG program, agreements entered into in one calendar year may result in annual grant payments for the succeeding 12 years. Therefore, an increase in the maximum amount of the total annual liability of $15 million for one year may have a fiscal impact of up to $180 million over a 12-year period. Second, the act extends the sunset on the JDIG program by an additional two years, through the end of the 2009 calendar year. As with the increase discussed above, this two-year extension of the program could have a significant fiscal impact stretching out for a dozen years or more.

The act makes significant changes to the clawback provisions under the JDIG program. Under the JDIG program, the Economic Investment Committee (EIC), the entity that administers the JDIG program, is required to amend or terminate the agreement and to recapture all or part of a grant made in previous years under certain circumstances. If the business fails to comply with any term of the agreement or with criteria developed by the EIC, the EIC must amend the agreement and may terminate the agreement. This amendment may take the form of a lower percentage being used to determine the amount of the grant or of a shorter term for the agreement. The reduction must be proportional to the failure to comply with the agreement. If the business fails to comply with any term of the agreement or with criteria developed by the EIC for two consecutive years, the EIC must terminate the agreement. In addition, in each agreement the EIC must include a provision describing the conditions that will lead to recapture of a grant made in an earlier year.

Under this act, the provisions relating to failure to comply with the agreement for two consecutive years are changed so that termination of the agreement is not required in all cases. Under this act, if the business is still in the base period established by the EIC, the EIC may withhold the grant for any consecutive year remaining in the base period in which the business fails to comply with the agreement. The EIC also has the option of extending the base period by up to 24 months over the amount specified in the original agreement in these cases. If the business does not come into compliance by the end of the base period, the agreement must be terminated. If the business is no longer in the base period established by the EIC, the EIC must terminate the agreement. The effect of these changes is to allow a company more leeway in meeting the terms of an agreement in the early years of the agreement.

This act also expands the types of entities that are eligible to enter into agreements under the program. When the JDIG program was originally created, all but two specific industries were eligible for grants under the program. Those two industries were retail operations and professional and semiprofessional sports teams and clubs. The exclusion of professional sports was put into place, in part, due to concerns that the intent behind the program was to attract one or more major league sports teams to the State. This act provides an exception to that exclusion by allowing professional motorsports racing teams to be eligible for grants under the program.

The act also makes the following changes:

- Changes references to 'base years' to 'base period' and allows the EIC to set the base period. Under current law, the base years are the first two years, unless the EIC decides on a different period. This clarifies that the EIC has authority to set that base period. The base period may not contain more than 5 years in which grant payments are to be made.
- Changes the definition of 'new employee.' Under prior law, a 'new employee' could include an employee that was originally hired in the base period, was subsequently laid off, and then was subsequently rehired by the company during the term of the agreement. The act changes the law to exclude these rehires from the definition of new employee.
- Clarifies that the $6,500 cap per new employee and the 75% cap on the amount of a grant apply to the total amounts and not just the amount that flows to the business. This is important because the amount of a grant is reduced by 25% for a position located in a development tier three area[67] with that portion instead being directed to the Utility Account of the Industrial Development Fund. This clarifies that the two caps apply to both the amount that flows to the business and the amount that flows to the Utility Account.
- Clarifies that social security numbers related to the positions on which a grant is based must be included with annual reports to the EIC. The change further clarifies that the social security numbers and State and federal tax returns are tax information, which is protected from disclosure under general laws related to public records.
- Removes the State Controller from the disbursement process. In 2004, a JDIG Reserve was created within the Department of Commerce. Due to the manner in which that Reserve was established, the State Controller is not directly involved with disbursements to businesses from the JDIG Reserve. This act relieves the State Controller of certain duties related to certification of grant amounts and remittance of payments to grantees and transfers those duties to the Department of Commerce.
- Clarifies that the tier designation that determines whether a grant payment is subject to reduction is the designation that is in effect in the year in which the application is filed. Under prior law, the amount of a grant was reduced by 25% if the position with respect to which the grant was awarded was located in an enterprise tier four or five area. Under that law, it was not clear when that determination was supposed to be made – at the time the business applied for a grant, at the time a grant agreement was entered into, or at the time the grant payment was made.

Lastly, this part of the act directs the Department of Commerce to conduct a comprehensive study of the costs of the JDIG Program in relation to other State economic development incentive programs. The study should also include information on the use of the program in urban, suburban, and rural areas throughout the various geographic regions of the State. The Department must submit the report to the chairs of the House and Senate Finance Committees by February 1, 2007.

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[67] See S.L. 2006-252, Section 2.9(b).

Part II: Bill Lee Act Changes

The William S. Lee Quality Jobs and Business Expansion Act (hereinafter Bill Lee Act) was enacted in 1996, effective beginning with the 1996 tax year with a 2002 sunset. The Act is a package of State tax incentives and has been modified in each subsequent year. The incentives are primarily in the form of tax credits for investment in machinery and equipment and real property, for job creation, and for worker training. In 2000, the General Assembly extended the sunset on the Act until January 1, 2006. During the 2005 Regular Session, the General Assembly further extended the Act until January 1, 2008. However, the General Assembly changed the effective date from January 1, 2008, to January 1, 2007, in Section 1.3 of S.L. 2006-252.

There are several exceptions to the sunset date, one of which involves eligible major industries. Eligible major industries that qualify as such before January 1, 2006, are allowed to claim credits for business activity that occurs on or before January 1, 2010. A taxpayer is an eligible major industry if it will invest at least $100 million in acquiring, constructing, and equipping a facility and it is engaged in bioprocessing, the manufacture or distribution of pharmaceuticals or medicines, aircraft manufacturing, computer manufacturing, motor vehicle manufacturing, or semiconductor manufacturing.

The definition of eligible major industries for the purposes of the Bill Lee Act largely conforms to the list of taxpayers who are eligible for a refund on the sales and use taxes paid by the taxpayer on building materials for construction of a new facility in this State. Taxpayers that are eligible for the refund of sales and use taxes are not required to qualify as such by a specific date, but the refund provision does expire for purchases made on or after January 1, 2010.

Part II of this act extends by two years the time period in which eligible major industries may qualify for the extension of the Bill Lee Act. This provision allows for an extension of the Bill Lee Act to the taxpayers that qualify as an eligible major industry by January 1, 2008, rather than 2006.

Part III: Sales Tax Refund Changes

Part III of this act adds financial services, securities operations, and related systems development as an industry that is eligible for the sales and use tax refund related to certain building materials, effective July 1, 2006. The effect of this change is to make these types of taxpayers eligible for the extension of the Bill Lee Act discussed in Part II above. In addition, this part extends the sunset on the sales and use tax refund for all eligible industries by three years, until January 1, 2013.

Part IV: Internet Data Center Tax Exemption Changes.

Part IV of the act makes technical changes to the sales and use tax exemption for Internet data center facilities enacted as part of the 2006 Appropriations Act (S 1741, S.L. 2006). The changes were requested by the industry whose recruitment was the catalyst for the exemption.

SIMPLIFY FIRE TAX RATE/OTHER TAX CHANGES.

Session Law	*Bill #*	*Sponsor*
S.L. 2006-196	**HB 1891**	**Rep. Wainwright, Luebke, Church, Hill**

AN ACT TO CLARIFY AND SIMPLIFY THE APPLICATION OF THE ADDITIONAL GROSS PREMIUMS TAXES ON FIRE AND LIGHTNING COVERAGE AND TO MAKE TECHNICAL AND CLARIFYING TAX LAW CHANGES.

OVERVIEW: This act does the following:

- Clarifies and simplifies the application of the additional gross premiums taxes on fire and lightning coverage. This part of the act was a recommendation of the Revenue Laws Study Committee.
- Makes a conforming change to the definition of 'holding company' for purposes of the franchise tax.
- Clarifies the application of the royalty reporting option when one of the related members is in a foreign country.
- Allows the Department of Revenue to share information with a county or city on a room occupancy tax to the same extent as a prepared food and beverage tax.
- Directs the Revenue Laws Study Committee to study various issues.

FISCAL IMPACT: Effective January 1, 2008, the act combines the statewide and local rates for insurance policies providing fire and lightning coverage and establishes a new statewide rate of 0.85% for the supplemental tax. The tax will apply to 100% of premiums for property coverage and 10% of premiums for automobile physical damage. Because the new statewide rate is calculated to be revenue neutral, it is estimated that the rate change will have no fiscal impact. The remaining sections of the act also have no fiscal impact.
(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2006 Session. Available in the Legislative Library.)

EFFECTIVE DATE: There are various effective dates.

ANALYSIS: This act makes several changes to the State and local tax laws.

Additional Gross Premiums Taxes on Fire and Lightning Coverage

North Carolina imposes a 1.9% tax rate on the gross premiums of most insurance policies.[68] 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 statute specifically excludes marine and automobile policies from this additional tax. Twenty-five percent of the net proceeds of this additional tax are credited to the Volunteer Fire Department Fund,[69] and the remainder is

[68] 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%.
[69] 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.

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.[70]

The General Assembly enacted the additional statewide fire and lightning tax in 1959. Although the statute does not provide that the tax will apply differently to different types of policies, the Department of Revenue has administered the tax this way. The additional tax has been imposed on 100% of premiums from insurance that covers only fire losses and on a percentage of premiums from insurance that covers multiple risks. The percentages applied are neither statutory nor imposed by administrative rule. Within the past few years, the Department has been informally advised by both the Department of Insurance and the Attorney General's Office that the statute as written does not provide for assessing the tax against only a percentage of a policy's premium. Rather, without a statutory change, it is their opinion that the tax should be applied to 100% of the premiums of any policy that includes fire and lightning coverage.

Section 1 of this act codifies the current administrative practice of the Department by setting in statute the percentage of an insurance policy's gross premiums to which the additional tax applies. It provides that policies covering fire loss would be taxable at 100%. It sets by statute the taxable percentages for the following types of policies:

Type of Insurance Policy	Taxable Percentage
Non-liability portion of a Commercial Multiple Peril policy	100%
Homeowner's Policy	50%
Farm Owner's Policy	30%

Section 3 of the act also establishes a new method of taxing insurance policies that provide property coverage, effective for taxable years beginning on or after January 1, 2008. The act broadens the base and lowers the rate applicable to insurance contracts that provide property coverage. The revenue-neutral tax rate is 0.85%. The revenue generated by the tax 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 local tax is 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 act 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. Section 7 of the act establishes a new method of distribution based upon a per capita allocation among fire districts, effective January 1, 2008. However, this new method of distribution needs further review. Given that, the act directs the Revenue Laws Study Committee to study the new method of taxation as well as the distribution of the revenues.

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[70] 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.*

'Holding Company' Definition

Section 9 of this act makes a technical change to the definition of a 'holding company' for franchise tax purposes. This change corresponds with a substantive provision in the budget which eliminates a franchise tax loophole that existed for LLCs that elect to be taxed as C Corporations. This section is effective for taxable years beginning on or after January 1, 2007. For a more detailed explanation of this provision and the corresponding technical change, see the analysis of Section 24A.2 of S.L. 2006-66.

Royalty Reporting Option

Section 10 of this act clarifies the application of the royalty reporting option when one of its related members is in a foreign country. This change corresponds to a substantive provision enacted in the budget expanding the scope of the royalty reporting option. This section is effective for taxable years beginning on or after January 1, 2006. For a more detailed explanation, see the analysis of Section 24A.3 of S.L. 2006-66.

Tax Sharing

Current law allows the Department of Revenue to share tax information with a county or city if the information is relevant to the administration of the county's or city's food and beverage tax. Section 11 of this act expands the provision to include the administration of a county's or city's room occupancy tax. This section became effective when the act became law on August 3, 2006.

Effective Date Correction of Research & Development Sales Tax Changes

Section 12 of this act changes the effective date of a budget provision exempting research and development equipment from State and local sales tax and imposing a 1% privilege tax, with an $80 cap from January 1, 2007, to July 1, 2007,. For a more detailed explanation, see the analysis of Section 24.9 of S.L. 2006-66.

Revenue Laws Study

Effective when the act became law on August 3, 2006, Section 13 of this act directs the Revenue Laws Study Committee to study the following issues:

- Distribution of the additional gross premiums tax on property coverage.
- Use of consolidated corporate returns.
- Replacement of the corporate income and franchise tax with a commercial activity tax.
- Revision of the administrative process for the review of disputed tax matters.

LOCAL GOVERNMENT DEBT REVISIONS.

Session Law	*Bill #*	*Sponsor*
S.L. 2006-211	**SB 1436**	**Senator Garrou**

AN ACT TO ALLOW REGIONAL COUNCILS OF GOVERNMENT TO FINANCE REAL PROPERTY ACQUISITIONS AND IMPROVEMENTS AND TO MAKE REVISIONS RELATED TO TAX INCREMENT FINANCING.

OVERVIEW: This act does three things:

- It gives regional planning commissions the same authority to acquire real property for office space that the General Assembly gave regional councils of government last session.
- It authorizes regional councils of government and regional planning commissions to finance real property purchases or improvements by pledging the real property as security for the debt, subject to approval by the Local Government Commission.
- It exempts a private agency that enters into a contract with a local government unit for the implementation of a development financing plan from the statutes governing government contracts to the extent specified in the contract.

FISCAL IMPACT: The act does not affect the General Fund.
(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2006 Session. Available in the Legislative Library.)

EFFECTIVE DATE: The act became effective when signed into law by the Governor on August 8, 2006.

ANALYSIS: Last session, the General Assembly gave regional councils of government the power to acquire real property by purchase, gift, or otherwise, and to improve that property for the purposes of meeting a council's office space and program needs.[71] A regional planning commission is very similar to a regional council of government. Both may be formed by a concurrent resolution adopted by one or more units of local government and both study regional problems and develop coordinated plans to address those problems. This act gives regional planning commissions the same authority to acquire real property as regional councils of governments.

The authority given to regional councils of government last year to own property did not include the authority to finance the purchase of the property. This act gives both regional councils of government and regional planning commissions the authority to pledge the real property as security in order to purchase the property or to make improvements to the property, subject to approval by the Local Government Commission.[72]

Project development financing, also known as tax increment financing, allows a local government to issue bonds to finance the public portion of certain economic development projects. The bonds are secured by the incremental property tax increase generated by the development financed. This type of financing can be used for airports, auditoriums and arenas, hospitals, museums, parking facilities, sewer systems, storm sewers and flood control facilities, water systems, street improvements, public transportation facilities, railroads, affordable housings, land development for industrial or commercial purposes, utilities, and redevelopment.

The Local Government Commission must approve the issuance of project development financing debt instruments. Before it can approve an issuance requested by a city, the governing body of the city must adopt a development financing plan. In implementing the plan, a city may act directly, through a redevelopment commission, through one or more contracts with private agencies, or by any combination of these. A city is subject to the public contract provisions of Article 8 of Chapter 143. This act provides that a private agency that enters into a contract

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[71] S.L. 2005-290.

[72] The incurrence of indebtedness by an entity created by any action of a unit of local government must be approved by the Local Government Commission under G.S. 159-153.

with a city for the implementation of a development financing plan is subject to the statutory provisions governing public contracts ONLY to the extent specified in the contract.[73]

EXEMPT AGRI-TOURISM FROM PRIVILEGE TAX.

Session Law	*Bill #*	*Sponsor*
S.L. 2006-216	**HB 143**	**Representative Coates**

AN ACT TO EXEMPT AGRI-TOURISM ACTIVITIES FROM THE PRIVILEGE TAX ON AMUSEMENTS.

OVERVIEW: This act exempts from the 3% gross receipts privilege tax all farm-related exhibitions, shows, attractions, or amusements offered on land used for farm purposes, including hayrides, animal exhibitions, and farm pond fishing.

FISCAL IMPACT: According to the Department of Revenue, a State privilege tax is not collected for activities such as hayrides and farm pond fishing because these activities are participatory in nature as opposed to other types of amusements subject to the tax. Animal exhibitions are considered to be taxable under current law. The Department is aware of only two instances in which current taxpayers would be affected by the act. It is unclear whether other businesses would be affected by the exemption. Because the act is retroactive to January 1, 1999, the first-year impact of the act would include any refunds to qualifying businesses that have paid the tax since that date.
(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2006 Session. Available in the Legislative Library.)

EFFECTIVE DATE: This act is effective retroactively to January 1, 1999, and applies to agri-tourism activities occurring on or after that date.

ANALYSIS: Under North Carolina law, amusements are generally subject to a privilege tax equal to 3%. Certain amusements are exempt from the imposition of a privilege tax. This act adds 'all farm-related exhibitions, shows, attractions, or amusements offered on land used for bona fide farm purposes as defined in G.S. 153A-340' to the list of exemptions from the privilege tax on amusements. The exemption would apply to hayrides, animal exhibitions, farm pond fishing, corn mazes, and other such attractions. The term 'bona fide farm purposes', as defined in G.S. 153A-340, includes the production of and activities relating or incidental to the production of crops, fruits, vegetables, ornamental and flowering plants, dairy, livestock, poultry, and all other forms of agricultural products having a domestic or foreign market.

FILM INCENTIVE CHANGES.

Session Law	*Bill #*	*Sponsor*
S.L. 2006-220	**HB 1522**	**Representative McComas**

[73] The City of Kannapolis plans to use project development financing to convert old Pillowtex factory buildings into research labs. It plans to enter into a contract with a private entity to implement its development financing plan.

AN ACT TO CONFORM THE TAX CREDIT FOR PRODUCTION COMPANIES TO THE STANDARD TAX TREATMENT WITH RESPECT TO THE DEDUCTION OF BUSINESS EXPENSES.

OVERVIEW: This act eliminates the prohibition against claiming both an income tax deduction and an income tax credit for the same qualifying expenses spent by a production company with regard to the film incentives tax credit.

FISCAL IMPACT: The act is estimated to reduce General Fund revenues by $8.1 million in FY 2007-2008, $8.5 million in FY 2008-2009, $9.0 million in FY 2009-2010, and $9.5 million in FY 2010-2011.
(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2006 Session. Available in the Legislative Library.)

EFFECTIVE DATE: This act is effective for taxable years beginning on or after January 1, 2007.

ANALYSIS: This act repeals the sections of the State's tax laws that prohibit a film and television production company from claiming both an income tax credit and deduction with respect to the same qualifying expenses. This means that a company claiming the film incentives tax credit no longer has to add back the qualifying expenses that form the basis of the credit to its taxable income, to the extent these expenses were not included in taxable income.

During the 2005 Session, the General Assembly replaced the film industry development grant program with a refundable income tax credit equal to 15% of the qualifying expenses spent by a production company in connection with a production.[74] A production company is defined as a person engaged in the business of making original motion picture, television, or radio images for theatrical, commercial, advertising, or educational purposes. In order to qualify for the credit, the production company must have qualifying expenses of at least $250,000 with respect to the production.[75] The credit expires for qualifying expenses occurring on or after January 1, 2010. This tax incentive benefits feature films, episodic television series, and commercial advertising. Qualifying expenses are the total amount spent in North Carolina for the following:

- Goods and services purchased by a production company in connection with a production. For goods with a purchase price of $25,000 or more, the amount included in qualifying expenses is the purchase price less the fair market value of the goods at the time the production is completed.
- Compensation and wages paid by a production company on which it remitted withholding payments to the Department of Revenue. Any amounts paid to an individual whose compensation is in excess of $1 million with respect to a single production cannot be included as a qualifying expense.

In order to claim the credit, the taxpayer must provide on its return a detailed accounting of the qualifying expenses. The credit may be claimed for the taxable year in which the production activities are completed. The credit is computed based on all of the taxpayer's qualifying expenses incurred with respect to the production, not just the qualifying expenses incurred during the taxable year. If the credit exceeds the amount of tax imposed for the taxable year reduced by the sum of all credits allowable, the Secretary of Revenue must refund the excess to the taxpayer. A pass-through entity is considered a taxpayer for purposes of claiming this credit; therefore, it does not distribute the credit among its owners.

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[74] S.L. 2005-276.
[75] In the case of an episodic television series, an entire season of episodes is considered one production.

As indicated, this act repeals the prohibition against claiming both a deduction and a credit for the same qualifying expenses, but the following limitations on the credit will continue. First, the amount of the credit with respect to a feature film production is capped at $7.5 million. Second, the production may not be any of the following: political advertising, television production of a news program or live sporting event, a radio production, or a production containing obscene material.[76]

VARIOUS ABC LAW CHANGES.

Session Law	*Bill #*	*Sponsor*
S.L. 2006-227	**HB 1025**	**Representative Luebke**

AN ACT TO MAKE VARIOUS CHANGES TO THE ALCOHOL BEVERAGE CONTROL LAWS.

OVERVIEW: Section 14 of this act requires the Secretary of Revenue to credit the Department of Commerce $200,000 quarterly from the net proceeds of the excise tax collected on unfortified wine.

FISCAL IMPACT: The impact on General Fund revenues is negligible.
(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2006 Session. Available in the Legislative Library.)

EFFECTIVE DATE: Section 14 of this act is effective July 1, 2007.

ANALYSIS: Under current law, the Secretary of Revenue is directed to credit, on a quarterly basis, the total of the net proceeds of the excise tax collected on unfortified wine bottled in North Carolina during the previous quarter to the Department of Commerce for use by the North Carolina Wine and Grape Council. The amount to be credited is capped at $500,000 per fiscal year. Under this act, the cap is removed and the source of the funds is changed to unfortified wine without regard to where it was bottled. Accordingly, the Secretary is directed to credit a flat amount of $200,000 per quarter, derived from the net proceeds of the excise tax collected on unfortified wine, to the Department of Commerce.

SPECIAL INDEBTEDNESS PROJECTS.

Session Law	*Bill #*	*Sponsor*
S.L. 2006-231	**SB 1621**	**Senator Hoyle**

AN ACT TO AUTHORIZE ADDITIONAL SPECIAL INDEBTEDNESS FOR THE CONSTRUCTION OF UP TO FIVE YOUTH DEVELOPMENT CENTERS; TO AUTHORIZE SPECIAL INDEBTEDNESS FOR THE PURCHASE OF STATE GAME LANDS; TO AUTHORIZE SPECIAL INDEBTEDNESS

[76] G.S. 14-190.1 defines "obscene material" as material that meets all of the following conditions: the material depicts or describes in a patently offensive way sexual conduct; the average person applying contemporary community standards relating to the depiction or description of sexual matters would find that the material taken as a whole appeals to the prurient interest in sex; the material lacks serious literary, artistic, political, or scientific value; and the material as used is not protected or privileged under the Constitution of the United States or the Constitution of North Carolina.

FOR A PARKING FACILITY IN DOWNTOWN RALEIGH; AND TO EXEMPT SALES OF TIMBER FROM THE SERVICE CHARGE IMPOSED BY THE DEPARTMENT OF ADMINISTRATION.

OVERVIEW: This act authorizes an additional $7 million in special indebtedness to complete five youth development centers for which special indebtedness was originally authorized in 2004. It authorizes the issuance of $20 million in special indebtedness to finance the purchase of land by the Wildlife Resources Commission to be used as State game lands. To assist with the repayment of this indebtedness, the act also exempts sales of timber on land owned by the Wildlife Resources Commission from the service charge imposed by the Department of Administration. Lastly, it authorizes the issuance of $20 million in special indebtedness to finance the construction of a new parking deck in downtown Raleigh.

FISCAL IMPACT: (For a complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2006 Session. Available in the Legislative Library.)

EFFECTIVE DATE: The authorization of additional special indebtedness for the construction of youth development centers is effective January 1, 2007. The remainder of this act became effective August 10, 2006.

ANALYSIS: This act authorizes the issuance of special indebtedness for various projects. Commonly referred to as 'certificates of participation', special indebtedness is nonvoted debt that is typically secured only by an interest in State property being acquired or improved. The term 'special indebtedness' covers the various forms this type of debt can take: installment purchase (with or without certificates of participation), lease-purchase (with or without certificates of participation), or bonds.

Before any type of special indebtedness may be issued or incurred, the State Treasurer must certify that debt financing may be desirable for a specific project presented to it by the Department of Administration. Next, the Council of State must give preliminary approval. If preliminary approval is obtained, the Council of State must give final approval, setting out details such as the maximum amount to be financed, the maximum maturity, and the maximum interest rates. The maximum maturity may not exceed 40 years. The State Treasurer must approve the details of the financing, finding that the amount to be borrowed is adequate and not excessive and will not require an excessive increase in any State revenues to provide for repayment, and that the special indebtedness can be incurred or issued on terms favorable to the State. Finally, the State Treasurer must report to the Joint Legislative Commission on Governmental Operations at least five days before any special indebtedness is issued or incurred.

In 2004, the General Assembly authorized the State to issue or incur up to $35 million of special indebtedness for five youth development centers with a total of 224 beds to be operated by the Department of Juvenile Justice. This act authorizes an additional $7 million of special indebtedness to complete the construction of five youth development centers for which special indebtedness was originally authorized in 2004. The increase in the amount of the authorization is due to bids on the projects coming in higher than anticipated in 2004.

This act also authorizes the issuance of up to $20 million of special indebtedness to finance the purchase of land by the Wildlife Resources Commission to be used as State game lands.

The proposed land acquisition involves a total of 77,090 acres currently owned by the International Paper Corporation and located in four separate tracts. The total estimated cost for purchasing the lands is $80 million, and the Nature Conservancy has approached the State to fund the purchase in the following manner:

- $45 million from the Clean Water Management Trust Fund
- $10 million from the Natural Heritage Trust Fund
- $5 million from the Parks and Recreation Trust Fund
- $20 million from the Wildlife Resources Commission

With the authorization provided by this act, the Wildlife Resources Commission would purchase roughly 66,000 acres of International Paper lands through a land deal brokered by the Nature Conservancy. The purchase of all 77,090 acres would occur over three years. It is anticipated that timber receipts from the land will be sufficient to repay the indebtedness.

The Department of Administration may assess and collect a service charge when a State agency transfers or sells any State surplus property or recyclable material. This act creates an exception to the service charge for sales of timber on land owned by the Wildlife Resources Commission. The effect of this would be to free up resources to repay the indebtedness.

Finally, this act authorizes the issuance of $20 million of special indebtedness to construct a parking deck in downtown Raleigh. The act does not, however, specify where in downtown Raleigh the deck will be located. The deck is expected to serve State employees and visitors to the State government complex. The act also requires the Department of Administration to report to the Joint Legislative Commission on Governmental Operations by September 1, 2006, on how this parking deck fits with the Green Square Project. The Green Square Project, authorized by S.L. 2005-255, is a proposal involving the sale by the State to the State Employees' Credit Union of land on which the credit union is currently situated. The property is located on the corner of Jones and Salisbury Streets, next to the Museum of Natural Sciences across from the Department of Administration. The State Employees' Credit Union intends to use the land to construct a building and parking deck for various uses.

PUBLIC-PRIVATE PARTNERSHIPS FOR SCHOOLS.

Session Law	*Bill #*	*Sponsor*
S.L. 2006-232, as amended by S.L. 2006-259	**SB 2009**	**Senator Malone**

AN ACT TO ALLOW CAPITAL LEASE FINANCING FOR PUBLIC SCHOOLS.

OVERVIEW: This act allows local school administrative units to enter into capital leases for school facilities and allows for those leases to contain an agreement relating to construction, repairs, or renovations.

FISCAL IMPACT: No fiscal impact.

EFFECTIVE DATE: This act became effective when signed into law by the Governor on August 12, 2006, and will be repealed on July 1, 2011.

ANALYSIS: Local school administrative units are responsible for providing for adequate public school facilities. Local governments have several options for financing the provision of public school facilities, including direct appropriations for construction, the issuance of special indebtedness or general obligation indebtedness (provided that the general obligation indebtedness is approved by a voter referendum), and the use of operating leases. Under prior law, a local board of education was prohibited from contracting for the erection of a school

facility unless the property on which the building was to be located was owned in fee simple by the local unit. In addition, all construction and repairs were required to be performed under the control and direction of the local board of education.

This act expands the financing authority of local school administrative units by allowing them to enter into capital leases for school facilities. The lease may relate to an existing building or new construction. The lease may also contain an agreement relating to construction, repairs, or renovations. Under a capital lease, the local school board is not required to own the property and the lease may provide that the lessor is responsible for repairs and renovations.

Capital leases differ from operating leases in several respects. In general, a capital lease is one that is considered to have the economic characteristics of ownership. To determine whether a lease is a capital lease or an operating lease, one must look at a number of different provisions in the lease. Under generally accepted accounting principles, a capital lease is a non-cancelable contract satisfying one or more of the following conditions:

- Legal title to the property is transferred to the lessee.
- The lease contains bargain or nominal purchase options.
- The lease term equals or exceeds 75% of the asset's useful life.
- The present value of the minimum lease payments equals or exceeds 90% of the asset's fair market value.

Under this act, all capital leases are subject to the following limitations:

- The lease cannot contain a clause that restricts the right of the local board to continue to provide a service or activity or to replace or provide a substitute for any property financed or purchased by a capital lease.
- Each capital lease is required to contain a clause specifying that it does not constitute a pledge of the taxing power or full faith and credit of the local board of education or board of county commissioners. This provision clarifies that a capital lease is not a general obligation of the local unit. Further, the act provides that no deficiency judgment can be rendered against a local board of education or other local government unit under the lease.
- A capital lease is considered a continuing capital outlay and is subject to the provisions of G.S. 115C-441(c1). That statute generally allows a local board of education to enter into a contract for continuing capital outlay provided that the budget resolution includes an appropriation for the current fiscal year, an unencumbered balance remains in the appropriation sufficient to pay in the current fiscal year the sums authorized under the contract, and the contracts are approved by the board of county commissioners in a resolution that binds the board to appropriate sufficient sums in later fiscal years. For capital leases, however, the resolution by the board of county commissioners requires only that the board make appropriations in later years in the board's discretion.
- A capital lease is subject to approval by the Local Government Commission (LGC) to the extent that the lease satisfies one or more of the conditions relating to financing agreements requiring approval by the LGC. These conditions are:
    - The agreement extends for at least five years.

    - The agreement obligates the unit to pay sums of money to another, regardless of whether the other is a payee, or the agreement obligates the unit to payments of over $500,000.

- A capital lease cannot contain any agreement with respect to student assignment.
- The property subject to a capital lease is subject to all laws relating to liens on private property.

In addition to the general provisions listed above, numerous additional provisions apply to a 'build-to-suit capital lease.' A build-to-suit capital lease is defined as a lease that provides for construction or renovation, the cost of which is estimated to exceed $300,000. The following provisions apply to build-to-suit capital leases.

- Before entering into a build-to-suit capital lease, the local board of education is required to adopt a resolution approving the lease. The board is required to provide at least 10 days' notice of the meeting at which the board plans to adopt the resolution approving the lease. The notice is required to include a brief description of the lease and the name of the other party to the lease. The resolution adopted by the board must include a finding that the capital lease is in the best interests of the unit and that the private developer (the lessor) is qualified to provide the products and services called for under the lease.
- All architectural, engineering, and survey services must be procured in accordance with the provisions of Article 3D of Chapter 143 of the General Statutes. Article 3D provides requirements to ensure that public entities procure qualified professionals when contracting for architectural, engineering, or surveying services.
- Private developers are required to seek competition and minority business participation in connection with the construction work. The private developer is required to conduct a competitive bidding process which could include prequalification of subcontractors. The private developer is required to comply with general law regarding minority business participation in public projects, and is required to adopt the minority business participation goals of the local board of education. The local board of education is required to approve of the private developer's plan for compliance with minority business participation prior to the private developer seeking bids.
- The board of education may require the private developer to provide performance or payment bonds in accordance with the provisions of Article 3 of Chapter 44A of the General Statutes. That Article provides for model provisions for performance bonds related to public construction contracts.
- A local board of education may enter into a predevelopment agreement with a private developer. Predevelopment agreements are required to be approved by the board of county commissioners and may involve such areas as site selection or building design.
- A local government unit is authorized to sell, lease, or otherwise transfer real property to a private developer for construction, repair, or renovation of a school facility under a capital lease without following general procedures related to the disposition of property.

- Each capital lease requires that the private developer provide an irrevocable letter of credit of not less than 5% of the total costs of the improvements for the benefit of laborers and materialmen.

BILL LEE CHANGES.

Session Law	*Bill #*	*Sponsor*
S.L. 2006-252	**HB 2170**	**Rep. Harrell, Daughtridge, Gibson, Owens**

AN ACT TO REPLACE THE TAX CREDITS GENERALLY AVAILABLE UNDER THE WILLIAM S. LEE QUALITY JOBS AND BUSINESS EXPANSION ACT WITH MORE NARROWLY FOCUSED CREDITS FOR JOB CREATION AND BUSINESS INVESTMENT.

OVERVIEW: This act creates a new Article under Chapter 105 to provide tax credits to new and expanding businesses, effective for taxable years beginning on or after January 1, 2007; sunsets the Bill Lee Act for activities occurring on or after January 1, 2007, rather than January 1, 2008; and makes conforming changes to other statutes that refer to provisions of the Bill Lee Act.

FISCAL IMPACT: The act does not have a fiscal impact in fiscal year 2006-2007, and a minimal impact on the State's General Fund in fiscal year 2007-08.
(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2006 Session. Available in the Legislative Library.)

EFFECTIVE DATE: The new tax credits and the sunset of the existing Bill Lee Act become effective January 1, 2007.

ANALYSIS: The William S. Lee Quality Jobs and Business Expansion Act was enacted in 1996, effective beginning with the 1996 tax year with a 2002 sunset. The Act is a package of State tax incentives and has been modified in each subsequent year. The incentives are primarily in the form of tax credits for investment in machinery and equipment and real property, for job creation, and for worker training. Counties are divided into five enterprise tiers based on the unemployment rate, per capita income, and population growth of the county. For many of the credits, the lower the tier of a county, the more favorable the incentive. The Act requires the Department of Commerce and the Department of Revenue to report periodically on the credits allowed by the Act.

Before 1996, North Carolina had made little use of tax incentives to lure businesses to the State. Even without incentives, North Carolina was consistently one of the top states in attracting industry. The array of credits authorized by the Bill Lee Act was viewed as an experiment, to be evaluated in five years to determine whether the incentives were cost effective and actually affected behavior or merely provided tax reductions to businesses that would have located or expanded in any case. In 2000, the General Assembly extended the sunset on the Act until January 1, 2006. In 2005, the General Assembly approved a two-year extension of the Act, until January 1, 2008, in order to provide additional time to study alternatives to the Act. This act changes the sunset for the Bill Lee Act from January 1, 2008, to January 1, 2007.[77]

[77] There are several exceptions to the 2007 sunset date. Interstate air couriers are eligible to claim the credits for business activity that occurs on or before January 1, 2010, provided that the interstate air

Part 1: Tax Credits for Growing Businesses

This act creates a new package of State tax incentives to replace the Bill Lee Act for most taxpayers. These incentives become effective January 1, 2007, and expire January 1, 2011. Taxpayers that are eligible for the later repeal date of the Bill Lee Act may choose to take credits under the current Act or under the new provisions of Article 3J of Chapter 105[78] Many of the provisions of Article 3J are similar or identical to the provisions of the Bill Lee Act. There are some significant differences however.

General administration. – By November 30 of each year, the Department of Commerce must assign a tier designation to each of the 100 counties in the State. In order to make these assignments, the Department must give each county a 'development factor'. A county's development factor is determined by ranking all counties based on the following factors: unemployment, median household income, percentage population growth, and per capita adjusted assessed property value. Regardless of the development factor, any county with a population of less than 12,000 is automatically included in the counties with the 40 highest rankings, any county with a population of less than 50,000 is automatically included in the counties with the 80 highest rankings, and any county with a population of less than 50,000 and more than 19% of its population below the federal poverty level is automatically included in the counties with the 40 highest rankings. Regardless of the development factor, a county first designated as a tier one area in one of the two previous years is included in the counties with the 40 highest rankings. The 40 counties with the highest ranking will be designated as development tier one,[79] the next 40 highest counties will be designated as development tier two, and the remaining counties will be designated as development tier three.

This tier designation differs in several keys ways from the Bill Lee Act. First, under the Bill Lee Act, counties are divided into five tiers rather than three. Second, in order to make the Bill Lee Act tier designations, the Department of Commerce ranks all 100 counties based on the following three factors: unemployment, average per capita income, and percentage growth in population. The tier designation under the new Article substitutes median household income for per capita income and adds the new factor related to adjusted assessed property value per capita. Third, under the new Article, the number of counties in a tier would be fixed. If one county received a lower tier designation because of the population or low-tier status exception, another county would be moved to a higher tier. Under the Bill Lee Act, the adjustments may

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courier entered into a real estate lease on or before January 1, 2006, with an airport authority that provides for the lease of at least 100 acres of land for a term of at least 15 years. 'Eligible major industries' that qualify as such before January 1, 2008, are also allowed to claim credits for business activity that occurs on or before January 1, 2010. A taxpayer is an eligible major industry if it will invest at least $100 million in acquiring, constructing, and equipping a facility and it is engaged in bioprocessing, the manufacture or distribution of pharmaceuticals or medicines, aircraft manufacturing, computer manufacturing, motor vehicle manufacturing, semiconductor manufacturing, or financial services, securities operation, or related systems of development. (See Part III of S.L. 2006-168) In addition, projects that are located in development zones are eligible for credits for business activities occurring before January 1, 2010, if all of the following conditions are met: before January 1, 2006, the taxpayer signs a letter of commitment with the Department of Commerce; the Secretary of Commerce makes a written determination that the taxpayer will invest $10 million and create at least 300 new jobs at the facility within a three-year period; and the taxpayer invests at least $4 million and creates at least 20 new jobs at the facility before January 1, 2006.

[78] The legislation created a new Article 3I. However, the codifier codified the new Article as 3J to avoid any potential confusion since the Article could easily be misinterpreted as Article 31.

[79] For the 2007and 2008 taxable years, there will be 41 counties in development tier one.

move a county to a lower tier, but they do not result in any county being assigned to a higher tier. And last, the tier designation is made by November 30 of each year as opposed to December 31.

The Bill Lee Act also contains exceptions to the tier designation structure for certain multi-jurisdictional industrial parks. Under those exceptions, taxpayers located in certain industrial parks that are owned by multiple jurisdictions are eligible for credits as if they were located in the lower-tiered jurisdiction. The new Article retains these exceptions.

Development zones are another key feature of the Bill Lee Act. [80] Development zones were intended to be areas of high poverty within cities. Over the years, it has become clear that the development zones often include areas that are neither high-poverty nor particularly urban. The new Article replaces development zones with urban progress (UP) zones. UP zones are more narrowly focused than development zones. First, an UP zone must be entirely within the corporate limits of a municipality with a population of at least 10,000. Development zones are located, at least partially, in a municipality with a population of at least 5,000. Second, UP zones must meet more stringent guidelines with respect to poverty within the zone. Third, the total area of all UP zones in a municipality may comprise no more than 15% of the area of a municipality. There is no similar restriction on development zones.

The new Article also creates a new type of zone in which the credits are enhanced. The Article authorizes the creation of agrarian growth (AG) zones and provides those areas with the same benefits provided to UP zones. An AG zone must satisfy the following conditions: it must be composed of contiguous census tracts or block groups located within a single county that does not have any municipality with a population in excess of 10,000; each census tract or block group in the zone must have more than 20% of its population below the poverty level; and the area of the zone, less its smallest census tract, may not exceed 5% of the total area of the county. The Department of Commerce shall designate an area as an AG zone upon the request of a local government.[81]

Under the new Article, all of the credits may be taken against the franchise tax levied in Article 3 of Chapter 105, the income taxes levied in Article 4 of Chapter 105, the gross premiums tax levied in Article 8B of Chapter 105, or a combination of these taxes. The credits allowed under the Bill Lee Act are also allowed against these taxes; however, unlike this new Article, under the Bill Lee Act, a taxpayer may take a credit against only one of the three taxes.

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[80] Under the Bill Lee Act, the Department of Commerce is also responsible for designating development zones. Development zones were intended to be areas of higher poverty within urban centers. In order to be designated as a development zone, the area must satisfy all of the following conditions: every census tract or block group in the zone is located in a city with a population of at least 5,000, the zone has a population of at least 1,000, more than 20% of the population of the zone is below the poverty level, every census track or block group in the zone has more than 10% of its population below the poverty level or is immediately adjacent to a census tract or block group that has more than 20% of its population below the poverty level, and no census tract or block group in the zone is located in another development zone. Designation as a development zone is effective for two years. Location in a development zone leads to more favorable treatment for the taxpayer with respect to the wage standard, the credit for creating new jobs, the credit for investing in machinery and equipment, and the credit for worker training.

[81] S.L. 2006-66, Section 24.16, created AG zones under the Bill Lee Act. The AG zones under S.L. 2006-66 became eligible for Bill Lee credits in taxable year 2006. Under this act, the Bill Lee Act expires for taxable years beginning on or after January 1, 2007.

Under the new Article created by this act, the total amount of credits allowed may not exceed 50% of the amount of the taxpayer's combined tax liability for franchise, income, and gross premiums taxes. Under the Bill Lee Act, the credits are limited to 50% of the taxpayer's tax liability for the one tax against which the taxpayer chooses to apply it. As with the Bill Lee Act, this cap applies to the cumulative amount of credits for the current year and carryforwards of credits from previous years. Under the new Article, any unused portion of a credit with respect to the credit for creating jobs or investing in business property may be carried forward for the succeeding five years. This is also the standard carryforward period for the Bill Lee Act. Any unused portion of a credit with respect to the credit for investing in real property may be carried forward for the succeeding 15 years, as compared to the succeeding 20 years under the Bill Lee Act. Finally, as with the Bill Lee Act, credits with respect to a large investment (at least $150 million) may be carried forward for 20 years. The new Article shortens the carryforward period for some credits and eliminates some enhanced carryforward provisions altogether.

When filing a return for a taxable year in which the taxpayer engaged in activity for which the taxpayer is eligible for a credit, the taxpayer is required to submit a fee of $500 for each type of credit the taxpayer intended to claim with respect to an establishment.[82] The Bill Lee Act contains a similar fee requirement. Under the Bill Lee Act, there is a maximum fee of $1,500 per taxable year. Article 3J does not have a maximum fee amount.

As under the Bill Lee Act, each taxpayer claiming a credit under the new Article must provide any information required by the Secretary of Revenue to evaluate the eligibility of the taxpayer for the credit claimed.

As under the Bill Lee Act, the Department of Revenue and the Department of Commerce must report on various facets of the business tax incentives allowed under this new Article. By each May 1, the Department of Revenue must publish information itemized by credit and by taxpayer relating to the amount and tier designation of new jobs, new real property investment, and new business property. The Department of Commerce is required to make biennial reports on tax equity and the effectiveness of the tax incentives provided under this new Article. In addition to these periodic reports, the Department of Commerce, in consultation with the North Carolina Rural Center, Inc. and the lower-tiered counties, must develop additional strategies to enhance economic growth and development in enterprise tier one areas. The Department must report on the results of this study to the Joint Legislative Economic Development Oversight Committee by January 1, 2007.

As with the Bill Lee Act, credits under the new Article may not be taken more than six months after the deadline for filing the tax return (including extensions) on which they were claimed. This is more restrictive than is generally the case under North Carolina law. In general, an overpayment may be refunded only if the discovery is made or the written request for a refund made within 3 years of the date set by statutes for filing the return or within 6 months of the date of the overpayment, whichever is later.

Basic eligibility. – To be eligible for a credit under this new Article, a taxpayer must meet eligibility requirements with respect to type of business as well as established standards with

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[82] The fee revenue is credited to the General Fund. Under the Bill Lee Act, three-fourths of the fees collected are retained by the Department of Revenue to administer and audit the credits and the remaining fee amounts are retained as departmental receipts by the Department of Commerce to administer the act. This act recognizes that the cost of administering the act extends years beyond the filing of the actual tax return and that the costs of adequately administering and auditing the credits exceeds the amount of fee revenue.

respect to wages, health insurance, environmental impact, and health and safety programs. A taxpayer cannot claim the credit if the taxpayer has an overdue tax debt.

A business type generally is determined solely by reference to the primary activity of the particular establishment.[83] The following types of businesses are eligible for credits under the new Article:

- Aircraft maintenance and repair.
- Air courier services hub.
- Corporate headquarters, but only if additional eligibility requirements related to job creation are satisfied.
- Customer service call centers.
- Electronic shopping and mail order houses.
- Information technology and services.
- Manufacturing.
- Motorsports facilities.
- Motorsports racing teams.
- Research and development.
- Warehousing.
- Wholesale trade.

Business-type eligibility under the new Article is substantially different than under the Bill Lee Act. Under the Bill Lee Act, business type eligibility depends on several factors including the primary business of the taxpayer as a whole, the primary activity of the particular establishment, the location of the establishment, and the number of new jobs created. The following types of business are eligible under the Bill Lee Act:

- Air courier services, if the primary business of the taxpayer is air courier services.
- Data processing, if the primary business of the taxpayer is data processing.
- Manufacturing, if the primary business of the taxpayer is manufacturing, warehousing, or wholesale trade and the primary activity of the establishment is manufacturing.
- Warehousing, if the primary business of the taxpayer is manufacturing, warehousing, or wholesale trade and the primary activity of the establishment is warehousing, or if the primary activity of an establishment is warehousing, the

[83] The definition of 'establishment' under the new Article is different from the definition of 'establishment' under the Bill Lee Act. Generally, under the new Article, an establishment means a single physical location. Under the Bill Lee Act, an 'establishment' is defined by NAICS (North American Industry Classification System) as the smallest operating entity for which records provide information on the cost of resources – materials, labor, and capital – employed to produce the units of output. Under NAICS, an establishment is generally a single physical location; although there are many exceptions to this generality.

establishment is located in an enterprise tier 1-3 area, and the establishment serves 25 or more establishments of the taxpayer.

- Wholesale trade, if the primary business of the taxpayer is manufacturing, warehousing, or wholesale trade and the primary activity of the establishment is wholesale trade.
- Computer services, if the primary activity of the establishment is computer services.
- Electronic mail order house, if the primary activity of the establishment is an electronic mail order house and the electronic mail order house is located in an enterprise tier one through three area and creates at least 250 new jobs.
- Customer service center, if the primary business of the taxpayer is financial services or telecommunications, the primary activity of the establishment is a customer service center, and the center is located in an enterprise tier 1-3 area.
- Central office or aircraft facility, if the primary activity of the establishment is a central administrative office or a training or maintenance center for an interstate air passenger carrier and the establishment creates at least 40 new jobs.

Under Article 3J, motorsports facilities and motorsports racing teams are eligible for credits whereas they are not currently eligible under the Bill Lee Act. A larger group of manufacturers, warehousers, wholesale traders, electronic mail order houses, and customer service centers are eligible for credits under the new Article than under the Bill Lee Act. Under the new Article, credits for central administrative office facilities are restricted to those facilities that are corporate headquarters, and the credit for information technology and services replaces the Bill Lee Act credits for data processing and computer services.

In order for a corporate headquarters to qualify for credits under the new Article, the establishment must create at least 75 new jobs within a 24-month period. A taxpayer that satisfies this job creation requirement is eligible for credits in the year in which the requirement is satisfied and the two succeeding years. A taxpayer that later creates an additional 75 new jobs in a 24-month period may be eligible for an additional three-year period of eligibility, but only if the job creation occurred outside of any other period of eligibility.

A taxpayer is eligible for a credit under the new Article 3J only if the jobs provided by the taxpayer meet a wage standard. As with the Bill Lee Act, no wage standard applies in the lower-tiered areas.[84] For development tiers two and three, the jobs provided by the taxpayer must pay at least the lower of 90% of the average county wage or 110% of the average State wage to qualify for a tax incentive. This differs significantly from the manner in which the wage standard is calculated under the Bill Lee Act. Under the Bill Lee Act, for enterprise tier areas three through five, the jobs provided by the taxpayer must pay at least 110% of the applicable average weekly wage. The applicable average weekly wage of the county is the lowest of the following: the average weekly wage for all insured private employers in the county, the average weekly wage for all insured private employers in the State, and the average weekly wage for all insured private employers in the county multiplied by the county

[84] Legislation enacted in 2002 eliminated the wage standard in enterprise tiers one and two under the Bill Lee Act. Under the new Article, no wage standard applies in development tier one. Development tier one under the new Article is roughly equivalent to enterprise tiers one and two under the Bill Lee Act.

income/wage adjustment factor.[85] Under the new Article, for activities that occur in UP zones or AG zones, the wage standard is lower than for activities that occur in development tiers two and three outside of UP zones or AG zones. For UP zones or AG zones, the wage standard is 90% of the lesser of the average county wage and the average State wage. Under the Bill Lee Act, there is no wage standard for activities occurring in development zones.

Under the new Article, the wage standard is calculated in different ways for the credit for creating jobs and the credit for investing in business property. For the credit for creating jobs, the average weekly wage of the jobs for which the credit is claimed and the average weekly wage of all jobs at the establishment with respect to which the credit is claimed will be required to meet the relevant wage standard. For the credit for investing in business property, the average weekly wage of all jobs at the establishment with respect to which the credit is claimed must meet the relevant wage standard. This is equivalent to how the wage standard is applied under the Bill Lee Act for the credits for creating jobs and for investing in machinery and equipment. As with the Bill Lee Act, there is no wage standard for the credit for investing in real property because that credit is available only in the lower-tiered counties where the wage standard requirement does not apply.

Under the Bill Lee Act, all jobs, including part-time jobs, must be included in the wage standard calculation. However, part-time jobs that also provide health insurance are considered to have an average weekly wage at least equal to the relevant wage standard. For the purpose of calculating the wage standard, the weekly wage of a part-time job is converted to a full-time equivalency. Under the new Article, part-time jobs are not included in the calculation of the wage standard. As under the Bill Lee Act, all jobs that were filled for at least 1600 hours during the year in which the taxpayer engaged in the activity for which a credit was claimed would be included in the wage standard calculation under the new Article even if those jobs were not filled at the time the taxpayer claimed the credit.

As under the Bill Lee Act, a taxpayer is required to provide health insurance for all full-time jobs at the establishment in order to be eligible for a credit under the new Article. The taxpayer must pay at least 50% of the premiums for health insurance that met at least the minimum provisions of the basic health care plan of coverage recommended by the Small Employer Carrier Committee. Each year that a taxpayer claims an installment or carryforward of a credit, the taxpayer must provide certification that it continues to provide health insurance for all full-time employees. If the taxpayer ceases to provide health insurance, the credit expires and the taxpayer is not allowed to take any remaining installment or carryforward of the credit.

As under the Bill Lee Act, a taxpayer is ineligible for a credit under the new Article if the taxpayer has any pending administrative, civil, or criminal enforcement action based on alleged significant violation of any program implemented by an agency of the Department of Environment and Natural Resources or if the taxpayer has had any final determination of responsibility for any significant administrative, civil, or criminal violation of any program implemented by an agency of the Department of Environment and Natural Resources in the last five years. The Secretary of Environment and Natural Resources is required to notify the Department of Revenue of all persons who currently have any of these pending actions or who have had any of these final determinations in the past five years.

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[85] The county income/wage adjustment factor is the county income/wage ratio divided by the State income/wage ratio. The income/wage ratio is determined by dividing the average per capita income in the relevant jurisdiction by the annualized average wage for all insured private employers in the jurisdiction.

As under the Bill Lee Act, a taxpayer is ineligible for a credit under the new Article if the taxpayer had any outstanding violations under the Occupational Safety and Health Act that had become a final order for 'willful serious' or 'failure to abate serious' violations within the past three years. The Department of Labor must notify the Department of Revenue of all employers who have had these citations become final orders in the past three years.

As under the Bill Lee Act, a taxpayer is ineligible for a credit under the new Article if the taxpayer has any overdue tax debts. An overdue tax debt is any part of a tax debt that remains unpaid 90 days or more after a notice of final assessment was mailed to the taxpayer. A tax debt is a final assessment after all possibilities for appeal have been exhausted.

Expiration. – Under the Bill Lee Act, credits may expire for several reasons. If the taxpayer is no longer engaged in an eligible type of business or if the number of jobs of an eligible business falls below the minimum number required, the credit expires. Generally, if a credit expires, the taxpayer may not continue to take installments of the credit, but may continue to take carryforwards of installments that accrued in previous years.[86] The credit for creating jobs and the credit for investing in machinery and equipment expire if the jobs are no longer filled or if the machinery and equipment are taken out of service used in an eligible business. The credit does not expire if the enterprise tier designation of an eligible taxpayer changes after the credit is first claimed. The credits under the new Article retain these expiration provisions.

Forfeiture. – Under the Bill Lee Act, a taxpayer forfeits a credit if the taxpayer was not eligible for the credit in the year in which the taxpayer engaged in the activity for which the credit was claimed. A taxpayer that forfeits a credit is liable for all past taxes avoided as a result of the credit plus interest. The past taxes and interest are due 30 days after the date the credit is forfeited. The credits under the new Article retain these forfeiture provisions.

Credit for creating jobs. – A taxpayer is allowed a credit for creating new full-time jobs. In order to be eligible for this credit, the taxpayer must meet a job creation threshold based on the development tier designation of the location where the jobs are created.[87] If the taxpayer creates jobs in more than one county during a year, the threshold applies separately to each county. If the taxpayer creates jobs at more than one establishment in a single county during a year, the threshold applies jointly to all establishments within the county. In addition, the amount of the credit varies depending on the development tier designation of the area in which the job is located. A job is located in an area if 50% or more of the employee's duties are performed in the area. The full amount of the credit cannot be taken in the first year, but instead must be taken in four equal installments beginning with the taxable year following the year in which the employee was hired. Jobs transferred from one part of the State to another do not qualify for the credit. In addition, jobs transferred within the State from a related member of the taxpayer to the taxpayer do not qualify for the credit. The amount of the credit and the job creation threshold are equal to the amounts in the following table based on the development tier area in which the job is located. In addition, a job created in an UP zone or an AG zone is eligible

[86] Expiration of a credit because the taxpayer ceases to provide health insurance is an exception to this general rule. In that case, the taxpayer may not claim installments or carryforwards after the credit expires.

[87] For jobs created in an UP zone or an AG zone, the threshold applicable to development tier one would apply.

for an additional credit of $1,000 and if that job is filled by a resident of the zone or a long-term unemployed worker,[88] it would be further increased by an additional $2,000.

Area Development Tier	Amount of Credit	Threshold
Tier One	$12,500	5
Tier Two	5,000	10
Tier Three	750	15

Under the new Article, if in one of the four years in which the installment of a credit accrues, the jobs with respect to which the credit was taken were unfilled, the credit related to those specific jobs would expire and the taxpayer would not be allowed to take any remaining installments of the credit. If, in one of the four years in which the installment of a credit accrues, the total number of jobs fell below the sum of the applicable job creation threshold and the number of jobs existing in the year before the new jobs were created, the credits with respect to all the new jobs would expire and the taxpayer would not be allowed to take any remaining installments of the credits. If, in one of the four years in which an installment of the credit accrued, a job that qualified for the credit was subsequently transferred to another area, the remaining installments of the credit would be calculated as if the job had been initially located in the later area.

Under the new Article, a taxpayer that plans to create new jobs in a specific area during the next two years may sign a letter of commitment with the Department of Commerce in order to lock-in the current year's development tier designations for the purposes of this credit. If the taxpayer created the jobs within the next two years, the taxpayer would be allowed to compute the amount of the credit based on the designations in effect in either the year in which the letter of commitment was signed or the year in which the jobs were created. If the taxpayer did not create the jobs in the next two years, the taxpayer could still claim a credit under the existing tier designation if the jobs were later created.

A taxpayer cannot claim a credit under the new Article and under the Bill Lee Act with respect to the same job. This restriction is important because the Bill Lee Act will remain in effect for a limited group of taxpayers until 2010.

There are several significant differences between the new credit for creating jobs and the credit that currently exists under the Bill Lee Act. First, the Bill Lee Act credit does not require the taxpayer to meet a job creation threshold whereas the new credit does. Second, the amount of the credit per job is more generous for some taxpayers under the new credit than under the existing Bill Lee Act credit. And third, the credit is based on the average number of jobs filled during the year rather than the year-end total.

Credit for investing in machinery and equipment. – Under this act, a taxpayer is allowed a credit for the amount by which the cost of the eligible investment amount of business property placed into service during a taxable year exceeds a threshold. The eligible investment amount is the lesser of (i) the cost of the eligible business property and (ii) the net increase in eligible business property over the base year (the year of the preceding three years in which the taxpayer had the largest amount of business property in service in the State). In order to be eligible for the credit, the taxpayer must place new business property into service in excess of a threshold based on the development tier designation. The credit is taken in four equal installments, beginning the year after the equipment is placed in service. The amount of the credit is equal

[88] A 'long-term unemployed worker' is defined as an individual that has been totally unemployed for at least the preceding 26 consecutive weeks.

to a percentage of the eligible investment amount of the business property. If the taxpayer places eligible business property into service in more than one county during a year, the threshold applies separately to each county. If the taxpayer places eligible business property into service at more than one establishment in a single county during a year, the threshold applies jointly to all establishments within the county. The following table sets out the relevant percentage and threshold for each development tier area:

Area Development Tier	Threshold	Credit Percentage
Tier One[89]	$ – 0 –	7%
Tier Two	1,000,000	5%
Tier Three	2,000,000	3.5%

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 taken is disposed of, moved out of State, or taken out of service, the credit expires and the taxpayer may not take any remaining installments of the credit unless the cost of that business property is offset in the same taxable year by the taxpayer's new investment in business property. If eligible business property that qualifies for a credit is subsequently transferred to another area, the remaining installments of the credit are calculated as if the business property had been initially located in the later area.

A taxpayer that plans to place specific business property in service at a specific location within the next two years may sign a letter of commitment with the Department of Commerce in order to lock-in the current year's development tier designation for the purposes of this credit. If the taxpayer places the eligible business property in service within the next two years, the taxpayer may compute the amount of the credit based on the designations in effect in either the year in which the letter of commitment was signed or the year in which the business property is placed in service. If the taxpayer does not place the business property in service in the next two years, the taxpayer may still claim a credit under the existing tier designation if the business property is later placed in service.

A taxpayer cannot claim a credit under the new Article 3J and under the Bill Lee Act with respect to the same business property. This restriction is important because the Bill Lee Act will remain in effect for a limited group of taxpayers until 2010.

There are significant differences between the new credit for investing in business property and the credit currently allowed under the Bill Lee Act for investing in machinery and equipment. First, the thresholds under the new credit differ from the thresholds under the existing credit. Second, the definition of 'business property' under the new credit is broader than the definition of 'machinery and equipment' under the existing credit. Third, the percentage that determines the amount of the credit under the new credit differs from the percentage for the existing credit for some taxpayers. And lastly, the new credit is taken in equal installments over four years rather than seven.

Credit for substantial investment in other property. – Under this act, a taxpayer that is located in a development tier one area is eligible for a credit for investment in real property. In order for the taxpayer to claim this credit, the Secretary of Commerce must make a written determination that the taxpayer is expected to invest at least $10 million in real property at a location within a three-year period and that the taxpayer will create at least 200 new jobs at the location within two years of the time that the property is first used in an eligible business. The taxpayer

[89] For the purposes of this credit, investment that occurs in an UP zone or an AG zone is subject to the threshold and percentage applicable to activity that occurs in a development tier one area.

may begin to claim the credit once the property is first used in an eligible business. The amount of the credit is equal to 30% of the eligible investment amount and must be taken in installments over a seven-year period. The new credit does not have a ceiling on the amount of credit that may be taken. The credit for investment in real property expires if the number of people employed at the location falls below 200.

A taxpayer cannot claim both the new credit for investment in real property and either of the existing Bill Lee Act credits for investment in real property with respect to the same property. This restriction is important because the Bill Lee Act will remain in effect for a limited group of taxpayers until 2010.

The only significant difference between the new credit for investment in real property and the Bill Lee Act credit for substantial investment in other property is the carryforward period. Under the Bill Lee Act, unused portions of the credit can be carried forward for up to 20 years. Under the new Article, unused portions of the credit may be carried forward for up to 15 years.

Expiring credits. – The Bill Lee Act contains five credits that do not have a counterpart in this new Article. Those credits are as follows:

- Technology commercialization credit. The technology commercialization credit is essentially an enhanced version of the credit for investing in machinery and equipment for taxpayers that are making significant investments in certain types of machinery and equipment. There is no similar enhancement in the new Article; however, the technology commercialization credit was designed with a specific project in mind that never came to fruition and, therefore, the credit has never been claimed.

- Credit for research and development. The Bill Lee Act contained a credit for research and development expenditures. In 2004, the General Assembly created a new, stand-alone credit for research and development (See Article 3G of Chapter 105 of the General Statutes). Therefore, no similar credit is included in the new Article.

- Credit for worker training. The Bill Lee Act contains a credit with which a taxpayer could offset certain worker training expenses. There is no similar credit in the new Article.

- Credit for investing in central office or aircraft facility property. The Bill Lee Act contains a credit for investing in central office or aircraft facility property. The credit is equal to 7% of the eligible investment amount and is capped at $500,000. There is no similar credit in the new Article though a business that would have been eligible for this credit under the Bill Lee Act is eligible for the credit for investing in real property under the new Article if the requirements of that credit are satisfied.

- Credit for development zone projects. This credit allows a taxpayer to claim a credit equal to 25% of a donation to a development zone agency for an improvement project in a development zone. There is no similar credit in the new Article.

Extension of Bill Lee Act for taxpayers signing a letter of commitment. – This act allows certain taxpayers to claim credits under the Bill Lee Act rather than the new Article in certain circumstances. There are any number of companies that are currently considering expanding in or relocating to North Carolina. Many of the expansions or relocations have been considered assuming that the credits allowed under the Bill Lee Act would be available through at least its current repeal date, 2008. For some taxpayers, the Bill Lee Act would allow for more generous

credits, whereas for other taxpayers the credits under the new Article 3J would be more generous. The act allows taxpayers that sign a letter of commitment with the Department of Commerce on or before December 31, 2006, that describes the specific project to claim credits under the Bill Lee Act for the 2007 taxable year rather than under the new Article. The legislation clarifies that if a taxpayer elects to take any credit under the Bill Lee Act during the 2007 taxable year, the taxpayer may not take any credit under the new Article with respect to the same establishment for that taxable year. This restriction prevents a taxpayer from picking and choosing which Article would be more beneficial for each particular credit.

Part 2: Conforming Changes

Part II of the act makes a number of conforming changes. Since the creation of the Bill Lee Act in 1996, many other programs have adopted the enterprise tier designation as a proxy for the economic viability or the available resources of a county. Many of these programs deal with economic development, but the tier structure has also been adopted as a proxy in areas such as animal control and wetlands mitigation. In addition, some programs refer to other aspects of the Bill Lee Act such as development zones or the wage standard. Because the Article created in Part I of this act largely replaces the Bill Lee Act, the changes in Part II of this act should help to lessen confusion that would be inherent in the use of two different tier systems. Because the tier structures are not equivalent, the changes in this Part will benefit some areas while reducing benefits to other areas. The changes are briefly summarized below.

Research & development expenses. – Section 2.1 conforms the credit for research and development expenses to the new tier structure. Under current law, the credit for research and development expenses is more generous if the research is conducted in an enterprise tier one, two, or three area. Under this act, research conducted in a development tier one area will be eligible for the more generous credit. Because development tier one will contain fewer counties than enterprise tiers one, two, and three combined, this change could result in some taxpayers being eligible for a smaller credit.

Section 2.20 conforms eligibility requirements for the credit for research and development to the new Article. Under current law, in order to be eligible for that credit the taxpayer must satisfy the wage standard, health insurance, environmental impact and safety and health record requirements under the Bill Lee Act. This section changes the reference to those requirements under the new Article. This change could have the effect of making more taxpayers eligible for the credit because the wage standard requirement under the new Article is less strenuous than the requirement under the Bill Lee Act.

Sales & use tax refund for low enterprise tier machinery and equipment. – Section 2.2 conforms the sales and use tax refund for low enterprise tier machinery and equipment to the new tier structure. Under current law, a taxpayer is eligible for a refund of sales and use tax paid at the general rate on machinery and equipment put into service in enterprise tier one and two areas. This section adds a reference to development tier one. Because development tier one is expected to be roughly equivalent to, though including more counties than, enterprise tiers one and two combined, this change should have limited effect.

Sales & use tax refund on building materials for major eligible industrial facilities. – Section 2.3 conforms the sales and use tax refund on building materials for major eligible industrial facilities to the new tier structure. Under current law, a taxpayer must invest at least $50 million in an eligible facility in an enterprise tier one, two, or three area or $100 million in an eligible facility in an enterprise tier four or five area to be eligible for the refund. This section changes the requirement so that the $50 million threshold applies to facilities in development tier one and

the $100 million threshold applies to facilities in tiers two and three. Because development tier one will contain fewer counties than enterprise tiers one, two, and three combined, this change could result in some taxpayers being ineligible for a refund.

Industrial Development Fund. – Section 2.4 makes changes to the Industrial Development Fund to conform to the tier designation changes. Local government units in enterprise tiers one, two, and three are eligible for grants from the Fund to help create jobs. The grant funds may be used in limited ways mostly related to the provision of infrastructure, equipment, or building repairs. Generally, a local match is required unless the local government unit is in an enterprise tier one area. This provision would make the counties that have the 65 highest rankings (development tier one and slightly more than half of development tier two) eligible for grants from the Fund. In addition, no local match could be required for the counties that have the 25 highest rankings (slightly more than half of development tier one). The intent was to maintain the status quo with respect to the Industrial Development Fund.

Community Development Block Grant funds. – Section 2.4 conforms the guidelines adopted by the Department of Commerce relating to community development block grant funds to the new tier structure. Under current law, those guidelines must ensure that grants awarded in enterprise tier one areas do not require a local match and that priority is given to projects in enterprise tier one areas and development zones. This section changes those references. The reference to enterprise tier one is changed to the counties that have the 25 highest rankings (slightly more than half of development tier one) and the reference to development zones is changed to UP zones. Because the counties that have the 25 highest rankings would be roughly equal to enterprise tier one, this change should maintain the status quo with respect to enterprise tier one areas. On the other hand, because UP zones are more restrictive than development zones, this change could have the effect of eliminating some projects from priority consideration.

Jobs Development Incentive grants. – Section 2.6 changes a definitional reference under the JDIG statutes.

Section 2.7 conforms the JDIG job creation requirements to the new tier structure. Under current law, a business must create at least 10 new jobs in an enterprise tier one, two, or three area or 20 new jobs in an enterprise tier four or five area to be eligible for consideration for JDIG. This section changes those requirements so that a business must create at least 10 new jobs in a development tier one area or 20 new jobs in a development tier two or three area to be eligible for consideration. Because development tier one will contain fewer counties than enterprise tiers one, two, and three combined, this change could result in some taxpayers being ineligible for consideration for JDIG. However, all businesses that have received JDIG grants have created far more jobs than the minimum required; therefore, this change will not likely have any practical effect.

Section 2.8 conforms a reference to tiers under the JDIG reporting requirements.

Section 2.9 conforms the JDIG grant reduction requirements to the new tier structure. Under current law, a business that is located in an enterprise tier four or five area when the grant is awarded would have the amount of a grant reduced by 25%, with that reduction flowing to the Utility Account of the Industrial Development Fund rather than to the business. This section changes that reference. Under this provision, for development tier three, the amount of the reduction remains at 25% and for development tier two, the reduction is equal to 15%. This section roughly maintains the status quo in enterprise tier five, provides a benefit to enterprise tier four, and lessens the amount of the grant for enterprise tier three.

Tax increment financing. – Section 2.10 conforms a provision relating to tax increment financing to the new tier structure. This section expands an exception created for financing districts related to tourism-related economic development projects. Under current law, this exception is allowed only in an enterprise tier one area. This section allows that exception in a development tier one area. Because development tier one would contain more counties than enterprise tier one, this change expands the exception.

Spay/Neuter Account. – Section 2.11 conforms provisions dealing with the Spay/Neuter Account to the new tier structure. Under existing law, there is an account that helps offset the cost incurred by cities and counties for the spaying and neutering of animals. Fifty percent of the funds in the account are reserved for cities and counties in enterprise tiers one, two, and three. The remaining 50% is reserved for cities and counties in enterprise tiers four and five. If there are excess funds after all needs have been met in enterprise tier one, two and three areas, those funds are transferred and used in enterprise tier four and five areas. The funds designated for a group of tier areas are then allocated based on population. This section changes this breakdown so that the division is between development tier one areas and development tier two and three areas. Because development tier one will contain fewer counties than enterprise tiers one, two, and three combined, this change could result in some cities and counties getting more assistance and some cities and counties getting less assistance.

Farmland Preservation Trust Fund. – Section 2.12 conforms a provision relating to agricultural easements and the Farmland Preservation Trust Fund to the new tier structure. Under current law, enterprise tier one, two, and three counties that have prepared countywide farmland protection plans are not required to match funds from the Farmland Preservation Trust Fund used to purchase agricultural easements. This section changes that reference to development tier one. Because development tier one will contain fewer counties than enterprise tiers one, two, and three combined, this change could result in some counties being newly subject to the match requirement.

Clean Water Management Trust Fund. – Section 2.13 corrects a definition relating to the Clean Water Management Trust Fund. The Article establishing the Fund refers to an "economically distressed county as defined by G.S. 105-129.3". Although G.S. 105-129.3 is the statute that specifies tier designation under the Bill Lee Act, there is no definition in that statute of an 'economically distressed county'. There is, however, a definition of an economically distressed county under the statute dealing with the Industrial Development Fund. This provision corrects that statutory reference. As discussed above, the definition under the Industrial Development Fund was changed in section 2.4 of this act, but that change roughly maintained the status quo.

Wetlands mitigation. – Sections 2.14 through 2.17 conform provisions dealing with wetlands mitigation to the new tier structure. Under current law, when the State purchases land for wetlands mitigation it is required to make a payment in lieu of taxes to the county in which the land is located if the county is an enterprise tier one or two area. These sections change those references to development tier one area. Because development tier one would have slightly more counties than enterprise tiers one and two combined, this change would require the State to make these payments in more instances.

Condemnation of unsafe buildings. – Sections 2.18 and 2.19 conform provisions dealing with condemnation of unsafe buildings to the new tier structure. Under current law, cities have more flexibility in condemning nonresidential buildings as unsafe if the building is located in a 'community development target area'. A community development target area is one that has characteristics of a development zone or similar characteristics. These sections change the

references from development zone to UP zone. Because of the amorphous nature of the definition of 'community development target area', this change should not have any impact.

Tax secrecy statute. – Section 2.21 amends the statutes relating to tax secrecy to ensure that the Department of Revenue may share information that is needed to administer the new Article with the Department of Commerce.

Mill rehabilitation tax credit. – Sections 2.22 through 2.24 amend the statutes relating to the mill rehabilitation tax credit passed earlier this year by the General Assembly in S.L. 2006-40. The mill rehabilitation tax credit is larger if the eligible site is located in an enterprise tier one, two, or three area. These sections change those references to development tiers one and two. Because development tiers one and two include more counties than enterprise tiers one, two, and three, these sections effectively allow for more generous credits at more sites.

Internet data centers. – Section 2.25 conforms the provisions of the sales and use tax exemption for eligible Internet data centers to the new tier structure. S.L. 2006-66, the 2006 Appropriations Act, created a sales and use tax exemption for certain Internet data service centers. In order to be eligible for that exemption, the center has to be located in an enterprise tier one, two, or three area. This section changes that reference to development tiers one and two, thereby enlarging the number of counties in which the center could be located and remain eligible for the exemption. In addition, this section makes technical changes requested by the industry for which the exemption was requested.

Definition of NAICS. – Section 2.26 cross references the definition of NAICS for sales and use tax purposes to the definition used under the Article created by this act.

2005

COMPUTER MANUFACTURING TAX INCENTIVES.

Session Law	*Bill #*	*Sponsor*
S.L. 2004-204	**S 2 Extra Session**	**Sen. Hoyle**

AN ACT TO PROVIDE A TAX CREDIT FOR CERTAIN MAJOR COMPUTER MANUFACTURING FACILITIES AND TO ENHANCE CERTAIN EXISTING TAX INCENTIVES FOR THOSE FACILITIES.

OVERVIEW: The act provides the following income, franchise, and sales tax incentives for a computer manufacturing facility that, along with related parties and strategic partners, is expected to invest at least $100 million of private funds in a facility in the State over a five-year period and employ at least 1,200 people within five years after the facility is used as a computer manufacturing and distribution facility:

- A new tax credit based upon the unit output and increased employment level of a major computer manufacturing and distribution facility. This credit may be used to eliminate 100% of a taxpayer's income and franchise tax liability. Any unused portion of the credit may be carried forward for the next succeeding 25 years.
- Enhanced Bill Lee Act tax credits that entitle a taxpayer to claim the credit amounts allowed for facilities located in a development zone regardless of the county in which the facility is located. The act also provides that the wage standard does not apply to the activities of a taxpayer at a major computer facility.
- An expansion of the sales tax refund, enacted by the 2003 General Assembly[1] for building materials purchased to build a computer manufacturing facility.

FISCAL IMPACT:

Description	*General Fund Impact*
Computer Manufacturing Credit	$10 million loss for 2005-2006 $10 million loss for 2006-2007 $20 million loss for 2007-2008 $20 million loss for 2008-2009 $20 million loss for 2009-2010
Bill Lee Act Changes Jobs Credit Machinery/Equipment Credit	 $600,000 loss for 2008-2009 $1 million loss for 2009-2010 $300,000 loss for 2007-2008 $500,000 loss for 2008-2009 $900,000 loss for 2009-2010

[1] S.L. 2003-435

Worker training Credit	$500,000 loss for 2007-2008 $400,000 loss for 2008-2009 $600,000 loss for 2009-2010
Real property Credit	$1.3 million loss for 2006-2007 $1.3 million loss for 2007-2008 $2.6 million loss for 2008-2009 $2.6 million loss for 2009-2010
Sales Tax Refund Expansion	No fiscal impact anticipated
Grand Total of losses	$11.3 million loss for 2006-2007 $22.1 million loss for 2007-2008 $24.1 million loss for 2008-2009 $25.1 million loss for 2009-2010

The amount of the computer manufacturing credit expected to be taken between 2005 and 2020 is $450 million. The amount of the Bill Lee Act credits expected to be taken between 2005 and 2020 is $42.8 million.
(For a more complete fiscal analysis, see Overview Fiscal and Budgetary Actions, 2004 Session. Available in the Legislative Library)

EFFECTIVE DATE: See Analysis for effective dates.

ANALYSIS: The Governor convened the Extra Session of the 2004 General Assembly to consider new and enhanced incentives for an eligible computer manufacturing and distribution facility. The following incentives were enacted by the General Assembly to persuade Dell Computer Corporation to locate a manufacturing facility in North Carolina:

Tax Credit based upon Unit Output of a Computer Manufacturing and Distribution Facility

Section 1 of the act creates a new tax credit for an eligible computer manufacturing and distribution facility.[2] The amount of the credit is based upon the facility's unit output and increased employment level. The credit is effective for business activities occurring on or after November 1, 2004, and for taxable years beginning on or after January 1, 2005. The credit expires for business activities occurring in taxable years beginning on or after January 1, 2020.

The tax credit may be taken against the taxpayer's franchise tax or income tax. The taxpayer must elect the percentage of the credit to be applied against the franchise tax with any remaining percentage to be applied against the taxpayer's income tax liability. Unlike other incentive tax credits, the election is NOT binding for either the year in which it is taken or for any carryforwards of the credit. A taxpayer may elect a different allocation for each year the taxpayer qualifies for a credit. A taxpayer may not claim a credit that exceeds 100% of the taxpayer's tax liability. Most other tax incentives allow the taxpayer to offset no more than 50% of its tax liability. Any unused portion of a credit may be carried forward for the next succeeding 25 years.

Credit Eligibility – To be eligible for this credit, the taxpayer must meet the following employment conditions:

[2] "Computer manufacturing" is defined in G.S. 105-164.14, as amended by this act. "Facility" is also defined in the act.

- The Department of Commerce must make a written determination that the taxpayer has or is expected to have an increased employment level of at least 1,200 new full time jobs OR new permanent part-time jobs converted into full-time equivalences within five years after the facility is operational.
- The taxpayer may meet this employment threshold either directly or indirectly through one or more related entities and strategic partners.[3] In order for a taxpayer to include jobs created by related entities and strategic partners in its increased employment level, the taxpayer must obtain their written consent to do so. Once granted, this consent is irrevocable. A job may not be included in the increased employment level of more than one entity. This credit is the first one the State has enacted that allows a taxpayer to meet an employment threshold indirectly through related entities and strategic partners.
- The taxpayer and the taxpayer's related entities and strategic partners must provide health insurance[4] for all of the full-time jobs each year it claims a credit or carryforward of a credit. The taxpayer does not have to provide health insurance for its part-time jobs. This condition is the same as the health insurance condition under the Bill Lee Act.

To be eligible for this credit, the taxpayer must meet the following investment condition:

The Secretary of Commerce must make a written determination that the taxpayer has invested or is expected to invest at least $100 million of private funds in a computer manufacturing and distribution facility over a five-year period. The investments may be made either directly or indirectly through related entities and strategic partners.

To be eligible for the credit, the taxpayer must also meet the following conditions that are typically required under other State tax incentives:

- The taxpayer and the taxpayer's related entities and strategic partners have no pending administrative, civil, or criminal enforcement actions based on alleged significant environmental violations, nor have they had a final determination of responsibility for any significant environmental violation within the past five years.
- The taxpayer and the taxpayer's related entities and strategic partners have no citations under the Occupational Safety and Health Act that have become a final order within the past three years for willful serious violations or for failing to abate serious violations.
- The taxpayer and the taxpayer's related entities and strategic partners have no overdue tax debts that have not been satisfied or otherwise resolved.

The taxpayer must apply to the Secretary of Commerce for the required eligibility determinations. The application must be made under oath. The determination is a question of fact and must be made whenever a taxpayer can demonstrate performance or provide a

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[3] The act defines a "related entity" as an entity for which the taxpayer possesses directly or indirectly at least 80% of the control and value. The act defines "strategic partner" as a business that is engaged in activities at the facility that directly contribute to the manufacture and distribution of computers and computer peripherals and with whom the taxpayer has contracted to provide those activities at the facility in direct support of its manufacturing and distribution activities.

[4] An entity provides health insurance if it pays at least 50% of the premiums for health care coverage that equals or exceeds the minimum provisions of the basic health care plan of coverage recommended by the Small Employer Carrier Committee pursuant to G.S. 58-50-125. This provision is the same as the insurance provisions of the Bill Lee Act.

credible plan for performance. If the taxpayer does not perform as promised, the taxpayer does not forfeit any of the credits already taken, unless the assertions of the taxpayer can be proven to have been false when made.[5]

Credit Amount - The credit amount and conditions vary from year to year based on complicated formulas. The actual amount of the credit is computed in two steps. First, one must determine the lesser of the cap and an amount determined by multiplying the number of units produced at the facility by a dollar amount. In some cases, this amount would be adjusted downward based on how much the actual increased employment level is below certain targets. In other situations, no downward adjustment is made for reductions in increased employment level.

If the amount of the credit computed in the first step is less than the cap, then the amount can be brought up to the cap by using amounts in a make up account. The make up account includes amounts by which prior year formula calculations exceeded the applicable caps. These amounts must be used within seven years. This credit is the first one the State has enacted that allows a taxpayer to carry forward credit amounts that could not be used because they exceeded the caps. It is also the first time the State has allowed a taxpayer to meet a cap by using prior year excesses.

In 2005, the taxpayer may claim a credit equal to $10 million if the taxpayer has invested at least $25 million by the end of the taxable year to construct a computer manufacturing and distribution facility. The investment may be made either directly by the taxpayer or indirectly through related entities.

For taxable years 2006 - 2009, the maximum credit allowed is $10 million. The actual amount of the credit is determined by the increased employment level of the taxpayer at the facility and the number of consumer-ready computers and computer peripherals produced, assembled, or manufactured by the facility during that taxable year, hereinafter referred to as 'unit output of facility'. The formula is as follows:

Credit amount = (Employment level adjustment factor)(Production factor)(Unit output of facility)

The employment level adjustment factor is the lesser of 1 or the increased employment level for the year divided by the applicable target increased employment level. Assuming the taxpayer meets the increased employment levels stated in the act, the adjustment factor would be 1. If the taxpayer fails to meet the targeted increased employment levels, then the factor would be a percentage less than 1, thereby reducing the amount of credit available to the taxpayer for that taxable year. The target increased employment level and the production factor vary for tax years 2006-2009 as follows:

Year	Increased employment level	Production factor
2006	600	$15
2007	1,000	$6.25

[5] One could argue that there is the potential for a court to find that allowing a credit for nothing more than a finding by the Secretary of Commerce violates the constitutional provision prohibiting the General Assembly from delegating the taxing authority because it potentially gives the executive branch the authority to pick and choose which taxpayers will receive credits. Under current law, when a taxpayer receives a tax benefit based on a determination by the Secretary regarding expected future activity, the tax benefits are subject to forfeiture if the taxpayer does not perform as expected. Because there is no forfeiture under the credit created in this act, if the taxpayer does not produce the expected jobs or make the expected investment, one could argue that the General Assembly has delegated its taxing authority to the Secretary.

2008	1,100	$6.25
2009	1,500	$6.25

For taxable years 2010-2014, the maximum credit amount depends upon the increased employment level attained by the taxpayer at the facility for which the credit is claimed.

- If the taxpayer has EVER attained an increased employment level of at least 1,500 at the facility for which the credit is claimed, then the credit amount for taxable years 2010-2014 is the unit output of the facility multiplied by $6.25 or $15 million, whichever is less. The credit amount would be reduced if the taxpayer's increased employment level decreased by more than 40% from that of the previous year. The reduction would be a percentage reduction equal to the increased employment level for the taxable year divided by 1,500.

- If the taxpayer never attained an increased employment level of at least 1,500, then the maximum credit amount remains at $10 million and the amount of the credit is reduced for any year the taxpayer does not reach an increased employment level of 1,500. The formula for determining the credit amount is:

  Credit = (Employment level adjustment factor)(Unit output of facility)($6.25)

  The employment level adjustment factor is the lesser of one and the number derived by dividing the taxpayer's increased employment level for the taxable year by 1,500.

For taxable years 2015-2019, the maximum credit amount may be increased to $20 million if the taxpayer has in ANY year attained an increased employment level of 2,500 at the facility for which the credit is claimed. The credit amount continues to vary depending upon the maximum increased employment level EVER attained and the current increased employment level.

- If the taxpayer has EVER attained an increased employment level of 2,500 AND the taxpayer's increased employment level for the current year is at least 1,500, then the credit amount is the unit output of the facility multiplied by $6.25 or $20 million, whichever is less.

- If the taxpayer has EVER attained an increased employment level of 2,500 BUT the taxpayer's increased employment level for the current year is less than 1,500, then the credit amount is the unit output of the facility multiplied by $6.25 or $15 million, whichever is less. The credit amount would be reduced if the taxpayer's increased employment level decreased by more than 40% from that of the previous year AND the increased employment level of the previous year was 1,500 or less or the increased employment level for the current year is 900 or less.

- If the taxpayer has EVER attained an increased employment level of 1,500, but has never attained an increased employment level of 2,500, then the credit amount is the unit output of the facility multiplied by $6.25 or $15 million, whichever is less. The credit amount would be reduced if the taxpayer's increased employment level decreased by more than 40% from that of the previous year AND the increased employment level of the previous year was 1,500 or less or the increased employment level for the current year is 900 or less.

- If the taxpayer has never attained an increased employment level of at least 1,500, then the maximum credit amount remains at $10 million and the amount of the credit is

reduced for any year the taxpayer does not reach an increased employment level of 1,500.

Constitutional Concerns - The credit set out in Section 1 of the act would be vulnerable to attack under the reasoning of the *Cuno* decision because it evinces a clear preference for in-State economic activity at the expense of out-of-state development. On September 2, 2004, the Sixth Circuit Court of Appeals issued its decision in *Cuno v. DaimlerChrysler*, 386 F.3d 738, (2004, 6th Cir. (Ohio)). In that decision, the Court found that Ohio's investment tax credit violated the Commerce Clause of the United States Constitution because it (a) encouraged in-state economic development at the expense of out-of-state economic development and (b) allowed the taxpayer to reduce pre-existing income tax liability by investing in-state but not by investing out-of-state.

Although the Sixth Circuit's decision is not binding in North Carolina[6] and is subject to further review[7] a similar case could be brought in this jurisdiction. If a decision applicable in this jurisdiction followed the reasoning of the Sixth Circuit opinion, the credit set out in Section 1 of the act would be ruled unconstitutional. If that happened, it is uncertain what the remedy would be. Possible remedies could include ordering the State to provide retroactive credits to otherwise similarly situated taxpayers who had made similar investments in other states.

The credit could also be vulnerable to attack on equal protection grounds because the amount of the credit is based, in part, on the maximum increased employment level ever attained by the taxpayer and not just on the current increased employment level of the taxpayer. Under this proposal, two companies that have identical output and increased employment levels in the current year could be eligible for substantially different credits based on the increased employment level attained in an earlier year.

For example, consider two companies – CorpA and CorpB. In 2010, CorpA has an increased employment level of 1,500 and CorpB has an increased employment level of 1,200. In that year, CorpA is eligible for a maximum credit of $15 million and CorpB is eligible for a maximum credit of $8 million. Further assume that in 2011, CorpA reduces its increased employment level to 1,200 and CorpB maintains its increased employment level at 1,200. CorpA remains eligible for a maximum credit of $15 million while CorpB remains eligible for a maximum credit of $8 million. Under this example, in 2011, two corporations with identical output and increased employment levels would be eligible for vastly different credits. A court could find that there is no rational basis for awarding CorpA almost double the amount of credit just because it once had an increased employment level of 1,500. In fact, one could argue that the distinction is irrational because the company that has laid off employees is the one that qualifies for the larger credit.

This problem is exacerbated in certain situations. Once a taxpayer has attained an increased employment level of 1,500, it can reduce its labor force by up to 40% a year without a reduction in the maximum amount of credit for which it is eligible. Continuing the example cited above, CorpA could reduce its increased employment to 900 in 2011 and still be eligible for a maximum credit of $15 million. In that case, CorpA would have less of a positive impact (i.e. 900 new jobs as opposed to 1,200 new jobs) in 2011 than CorpB, but be eligible for a much larger credit.

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[6] The decision is binding only in the states that compose the Sixth Circuit: Kentucky, Michigan, Ohio, and Tennessee.

[7] The United States Supreme Court will hear this case during the 2005-2006 Term.

Other Considerations – The credit, as enacted raises the following additional issues:

- The method for calculating the amount of a credit for which a taxpayer is eligible is extremely complicated. This may result in additional compliance and auditing burdens.

- There is no provision regarding expiration of a credit if the increased employment level is not maintained. Generally under prior law, when a taxpayer was allowed a credit for a certain activity, the credit expired if the activity was not maintained. For example, in order for a taxpayer to take full advantage of the credit for creating jobs under the Bill Lee Act, those jobs must be maintained for a number of years.

  The credit in this act is designed in a way that allows the taxpayer, under certain circumstances, to take the full benefit of a credit even if increased employment levels are not maintained. Once a taxpayer has attained an increased employment level of at least 1,500, the taxpayer may reduce its increased employment level by up to 40% each year without being subject to a reduction in the maximum amount of the credit for which it is eligible. For example, if a taxpayer has an increased employment level of 1,500 in 2010, the taxpayer would be eligible for a maximum credit of $15 million per year. In 2011, the taxpayer could reduce its increased employment level to 900 while maintaining eligibility for up to $15 million per year in tax credits. Then, in 2012, the taxpayer could reduce its increased employment level to 540 while still maintaining eligibility for a maximum credit of $15 million.

  Taken to the mathematical extreme, it is theoretically possible for a taxpayer to reduce its increased employment level by almost 99% over nine years while maintaining eligibility for the maximum amount of the credit. Continuing the example cited above, a taxpayer that had an increased employment level of 1,500 in 2010 that took the 40% reduction each year would have an increased employment level of just 16 by 2019 and would still be eligible for a maximum credit of $15 million.[8]

- There is no wage standard associated with this credit. The Bill Lee Act generally requires that jobs at the relevant facility satisfy a wage standard in order for the taxpayer to be eligible for a credit under that Act. A wage standard does not apply in tiers one and two or in development zones. Although there was no wage standard requirement for the alternative credit for cigarette exportation enacted in 2003, it was understood at the time that those jobs would easily satisfy the Bill Lee wage standard.

- The 25-year carryforward period for credits under this act is extremely long, although not unprecedented.

- This credit is the first one the State has enacted that would give one entity a credit for activity undertaken by another. North Carolina has struggled for years with companies using related entities as a tax avoidance mechanism. Companies create related Delaware holding companies and use accounting tricks to eliminate their North Carolina taxable income. Companies create complex chains of related companies to shift property into LLCs and avoid franchise tax. Shifting income and expenses between and among various related entities is the essence of tax avoidance. North Carolina is a separate entity filing state; therefore the Department of Revenue cannot view the entire

[8] The amount of the credit is also based on output at the facility. It is likely that a taxpayer that greatly decreased its employment level at a facility would also decrease output, so the taxpayer may not be able to take advantage of the maximum amount of the credit.

web of inter-related entities to determine the real economic effect of the actions of related entities.

Bill Lee Incentive Enhancements

Section 2 of the act provides that a taxpayer who is otherwise eligible for one of the tax credits under the Bill Lee Act and who qualifies for the tax credit for major computer manufacturing facilities is eligible for the following major computer facility enhancements under the Bill Lee Act, regardless of the enterprise tier designation of the county in which it is located. The taxpayer may include employees of or investments made by related entities or strategic partners to meet its Bill Lee eligibility requirements. The Bill Lee Act expires for computer manufacturing facilities in 2009.

- Wage Standard. – The wage standard does not apply to the activities of the taxpayer at the major computer facility. Under prior law, the wage standard was inapplicable only in tiers one and two or in development zones.
- Credit for Creating Jobs. – The amount of the credit for creating jobs is increased by $4,000 per job for jobs at the major computer facility. For jobs created at other facilities, the amount of the credit remains at $500 per job in a tier five county; $1000 in tier four; $3,000 in tier three; $4,000 in tier two; and $12,500 in tier one.
- Credit for Investing in Machinery and Equipment. – The threshold investment a taxpayer must meet to qualify for the credit and the amount of credit the taxpayer is allowed under the Bill Lee Act is the same as allowed under current law for a tier one county: a threshold amount of zero and a credit amount equal to 7% of the eligible investment. Under current law, the threshold for a tier five county is $2 million and the applicable credit percentage is 4%.
- Credit for Worker Training. – The maximum amount of the credit is $1,000 per worker. This is the same credit amount allowed to other taxpayers for jobs in a tier one area. If the jobs are not in a tier one area, then other taxpayers are allowed a $500 credit for worker training.
- Credit for Substantial Investment in Other Property. – Under prior law, this 30% credit was available only for property located in a tier one or two area. The credit in the act is available to a taxpayer who qualifies as a major computer manufacturing facility regardless of the enterprise tier area in which the property is located.

Sales Tax Incentives

In 2003, the General Assembly provided that the owner of an eligible facility that invests at least $100,000,000 of private funds to acquire, construct, and equip a facility in North Carolina was allowed an annual refund of sales and use taxes paid by it on building materials, building supplies, fixtures, and equipment that become a part of the real property of the eligible facility. An eligible facility includes computer manufacturing. If the owner of an eligible facility does not make the required minimum investment within five years after the first refund is allowed, the facility loses its eligibility and the owner forfeits all refunds already received. Upon forfeiture, the owner is liable for tax equal to the amount of all past taxes refunded plus interest. The tax and interest are due 30 days after the date of the forfeiture.

Section 3 of the act makes several changes to the sales tax refund statute as it applies to computer manufacturing. These changes are effective January 1, 2005, and apply to sales made on or after that date:

- It provides that the investment may be made directly by the taxpayer or indirectly through a related entity.
- It clarifies that a 'computer facility' may include multiple buildings on a single campus.
- It provides that the term 'computer manufacturing' includes peripheral equipment if the manufacture or assembly of this peripheral equipment occurs at the facility or campus at which the taxpayer also manufactures or assembles electronic computers.

Section 4 of the act adds an exemption to the confidentiality of tax information statute so that the State may verify information received by a taxpayer claiming the credit under the act with a related entity or strategic partner.

HURRICANE RECOVERY ACT OF 2005.

Session Law	*Bill #*	*Sponsor*
S.L. 2005-1	**SB 7**	**Senator Nesbitt**

AN ACT TO ENACT THE HURRICANE RECOVERY ACT OF 2005, MAKING FINDINGS AS TO DAMAGE CAUSED BY THE HURRICANES THAT STRUCK NORTH CAROLINA IN 2004, CONCERNING ESTABLISHMENT OF THE DISASTER RELIEF RESERVE FUND, MAKING APPROPRIATIONS TO THE DISASTER RELIEF RESERVE FUND, DIRECTING THE REESTABLISHMENT AND MODIFICATION OF HURRICANE FLOYD RECOVERY PROGRAMS, AUTHORIZING ESTABLISHMENT OF NEW PROGRAMS, EXPANSION OF EXISTING PROGRAMS, AND MODIFICATION OF EXISTING PROGRAMS TO IMPLEMENT THIS ACT, AUTHORIZING TRANSFER OF FUNDS TO FEDERAL AGENCIES AND LOCAL GOVERNMENTS, AUTHORIZING TIME-LIMITED POSITIONS TO IMPLEMENT THIS ACT, PROVIDING FOR SUBROGATION BY THE STATE OF CERTAIN INSURANCE CLAIMS, AUTHORIZING ADVISORY COUNCILS TO ADVISE STATE AGENCIES ON RECOVERY EFFORTS, PROVIDING FOR TAX EXEMPTION OF BENEFITS, DIRECTING THE MAPPING OF FLOOD PLAINS AND THE IDENTIFICATION OF POTENTIAL LANDSLIDE AREAS AND STREAM BANK EROSION, DIRECTING THE DEPARTMENT OF ENVIRONMENT AND NATURAL RESOURCES TO STUDY THE CAUSES OF FLOODING IN CERTAIN AREAS AND DETERMINE MEASURES TO PREVENT OR MITIGATE FUTURE FLOODING, DIRECTING THE GOVERNOR TO MAINTAIN THE REDEVELOPMENT OFFICE IN WESTERN NORTH CAROLINA, APPROPRIATING FUNDS TO RESTORE AND REPAIR CERTAIN PUBLIC BUILDINGS IN HYDE COUNTY DAMAGED BY HURRICANE ISABEL AND ESTABLISHING REPORTING REQUIREMENTS.

OVERVIEW: This act provides disaster assistance to individuals, businesses, and public agencies that sustained damage from one or more of the six hurricanes that struck North Carolina during the late summer and early fall of 2004. The Governor has established the Disaster Relief Reserve Fund in the Office of State Budget and Management, and this act makes appropriations to this Fund. It also provides greater income tax relief for recipients of disbursements from the Disaster Relief Reserve Fund than current law allows.

FISCAL IMPACT: The act appropriates $247,541,447 to the Disaster Relief Reserve Fund. The State income tax deduction is expected to result in a one-time loss of General Fund revenues of $1,575,000.
(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2005 Session. Available in the Legislative Library.)

EFFECTIVE DATE: The tax deduction became effective for taxable years beginning on or after January 1, 2004; the remainder of the act became effective when it became law, February 25, 2005.

ANALYSIS: North Carolina was struck by six hurricanes in 2004. Hurricanes Alex, Bonnie, Charlie, and Jeanne brought flooding and wind damage to the Eastern Region of the State. Hurricanes Frances and Ivan dumped heavy rains in the Western Region of the State resulting in landslides, flooding, and the death of at least 11 people. Forty-five counties in western North Carolina were included in federal disaster declarations as a result of Hurricanes Frances and Ivan. Nineteen of those counties were designated by FEMA as eligible for individual assistance and public assistance. Another twenty-six counties were designated as eligible for individual assistance. The damage in the Eastern Region resulted in State disaster declarations.

This act is known as the 'Hurricane Recovery Act of 2005'. It sets forth detailed findings regarding the impacts of the many hurricanes on individuals, businesses, and local governments in the affected areas. One of the findings states that further deterioration of the economy, environment, public health and safety, and quality of life in the State is likely to occur unless significant additional State assistance is allocated to the areas affected.

The act establishes the following 47 counties as eligible to receive assistance under the Act:

- The 19 counties that were designated as eligible for federal individual assistance and public assistance: Alleghany, Ashe, Avery, Buncombe, Burke, Caldwell, Haywood, Henderson, Jackson, Macon, Madison, McDowell, Mitchell, Polk, Rutherford, Swain, Transylvania, Watauga, and Yancey.
- The 26 counties that were eligible for federal public assistance: Alamance, Alexander, Bladen, Cabarrus, Caswell, Catawba, Cleveland, Columbus, Cumberland, Davidson, Forsyth, Gaston, Graham, Guilford, Hoke, Iredell, Lincoln, Mecklenburg, Randolph, Robeson, Rockingham, Rutherford, Scotland, Stokes, Union and Wilkes.
- The two counties that were not included in a federal disaster declaration but were included in a State disaster declaration as a result of the damages sustained by one of the hurricanes that occurred in 2004: Hyde and Dare.

The act notes that the Governor has established the Disaster Relief Reserve Fund for the purpose of providing necessary and appropriate assistance and relief needed as a result of natural disasters. Funds in the Disaster Relief Reserve Fund may be used for a variety of purposes such as housing buyout and relocation assistance, loans, infrastructure repair, studies, and federal matches. The Governor must report periodically to the Appropriations Committees and to the Joint Legislative Commission on Governmental Operations on the use of the money in the Fund. The act appropriates $247,541,447 to the Fund. This amount comes from the following sources:

- $91 million from unexpended General Fund appropriations for fiscal year 2004-2005.
- $153,541,447 million from the Savings Reserve Account. Of this amount, $30,000,000 must be used to implement the recommendations of the study on flood prevention and mitigation.
- $3 million in reversions from the NC Community Development Initiative for Hurricane Floyd recovery programs. (These are unused Hurricane Floyd Recovery funds)

The act also provides a State income tax deduction equal to the amount paid to the taxpayer, either individual or business, during the taxable year from the Disaster Relief Recovery Fund.

The deduction does not apply to amounts received as payments for goods and services provided by the taxpayer. Under current State and federal law, payments received to replace property lost in a federally declared disaster are exempt from tax. However, payments received to replace income are not exempt. Payments to farmers for crop losses would be an example of a taxable payment, as the crops are assumed to be converted into income. The General Assembly provided similar tax relief to Hurricane Floyd victims in 1999. The deduction is effective for taxable years beginning on or after January 1, 2004.

NASCAR HALL OF FAME FINANCING.

Session Law	*Bill #*	*Sponsor*
S.L. 2005-68	**SB 525**	**Senator Clodfelter**

AN ACT RELATING TO NASCAR HALL OF FAME FINANCING.

OVERVIEW: This act authorizes the Mecklenburg County Board of Commissioners to levy an additional 2% occupancy tax upon receiving written confirmation from NASCAR that it will locate the NASCAR Hall of Fame Museum facility in Charlotte. The net proceeds of the additional 2% occupancy tax can be used only for the acquisition, construction, repair, maintenance, and financing of the NASCAR Hall of Fame Museum facility and an adjacent NASCAR convention center ballroom facility. The additional 2% tax would bring the occupancy tax rate to 8% in Mecklenburg. No other county or city in North Carolina currently has an occupancy tax rate in excess of 6%.

FISCAL IMPACT: The act does not impact State revenues. The additional 2% occupancy tax rate will generate an additional $5.8 million in 2005-06 fiscal year for Mecklenburg County; the amount is projected to increase to $7 million by fiscal year 2009 - 2010.
(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2005 Session. Available in the Legislative Library.)

EFFECTIVE DATE: The act became effective when it became law, May 26, 2005.

ANALYSIS: NASCAR plans to locate a NASCAR Hall of Fame Museum in one of five cities. The City of Charlotte is one of the five locations being considered.[9] To finance the capital costs of building the facility, the City of Charlotte and Mecklenburg County requested, and the General Assembly enacted, authorization for Mecklenburg County to levy an additional 2% occupancy tax. Mecklenburg County currently has the authority to levy a 6% occupancy tax. Of the more than 74 counties and 65 cities authorized to levy a room occupancy tax, no locality has the authority to levy an occupancy tax in excess of 6%.[10]

In authorizing Mecklenburg County to levy an 8% occupancy tax, the General Assembly set strict parameters around the levy, use, and repeal of the tax. The act authorizes Mecklenburg County to levy an additional 2% room occupancy tax upon receiving written confirmation from NASCAR that it will locate the NASCAR Hall of Fame Museum facility in Charlotte. The proceeds of the additional 2% occupancy tax must be distributed to the City of Charlotte and used only

[9] The other cities are Daytona Beach, FL; Atlanta, GA; Richmond, VA; and Kansas City, KS.
[10] In 1993, a House Finance Subcommittee on Occupancy Tax established uniform guidelines for the occupancy tax legislation it considered. As a general rule, the House Finance Committee continues to follow these guidelines. One of those guidelines is that the combined city and county tax rate cannot exceed 6%.

for the acquisition, construction, repair, maintenance, and financing of a NASCAR Hall of Fame Museum facility and an ancillary and adjacent NASCAR convention center ballroom facility. By using the term 'proceeds' instead of the defined term 'net proceeds', the bill ensures that all of the proceeds of the additional 2% tax will be used for the stated purposes and that none of the proceeds will be used for administrative expenses associated with collecting and administering the additional 2% tax. Lastly, the act provides that the Mecklenburg County Board of Commissioners must repeal the tax effective the earlier of July 1, 2038, or July 1 following the date of final satisfaction of all debt instruments or obligations issued by the City of Charlotte (or a related special purpose entity) in connection with the financing or refinancing of the NASCAR Hall of Fame Museum facility.

ALLOW PAYMENT OF TAX BY OFFSET.

Session Law	*Bill #*	*Sponsor*
S.L. 2005-134	**SB 537**	**Senator Clodfelter**

AN ACT TO ALLOW THE PAYMENT OF TAXES IN LIMITED CIRCUMSTANCES BY OFFSET OF AN OBLIGATION OWED TO THE TAXPAYER BY THE TAXING UNIT.

OVERVIEW: This act provides that a taxing unit may, under limited circumstances, collect taxes through offset of an obligation owed to the taxpayer by the taxing unit.

FISCAL IMPACT: No fiscal impact.

EFFECTIVE DATE: This act became effective when signed into law by the Governor on June 29, 2005.

ANALYSIS: G.S. 105-357 provides that taxes owed to local taxing authorities are payable in existing national currency. A taxing unit is specifically prohibited from accepting the following as payment of taxes: deeds to real property; notes of the taxpayer; bonds or notes of the taxing unit; or payments in kind.[11] Prior to the enactment of this act, G.S. 105-357 also specifically prohibited a taxing unit from permitting the payment of taxes by offset of any bill, claim, judgment, or other obligation owed to the taxpayer by the taxing unit. This act provides that the prohibition against payment of taxes by offset does not apply to an offset of an obligation that arose under a lease or another contract entered into before July 1 of the fiscal year for which the taxes are levied.

This change was intended to facilitate the collection of taxes when a taxpayer has declared bankruptcy. When a taxpayer declares bankruptcy, the bankruptcy laws generally operate as a stay for all actions to collect pre-petition debts.[12] However, a creditor's right of setoff under non-bankruptcy law is preserved when the right of setoff arose before the commencement of the bankruptcy case.[13] To affect a setoff, a 'party in interest' must seek court approval from the automatic stay. The court will generally allow the setoff if the debt is a pre-petition debt and if the right of offset existed under applicable non-bankruptcy law. Prior to the enactment of this act, G.S. 105-357 prevented local taxing authorities from utilizing this form of collection in bankruptcy cases because, as applicable non-bankruptcy law, it forbid such an offset.

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[11] G.S. 105-241 provides that taxes owed to the State are payable in national currency. However, the statute does not specifically prohibit the right of setoff.
[12] 11 U.S.C. § 362.
[13] 11 U.S.C. § 553.

2005 CONTINUING BUDGET AUTHORITY/REVENUE.

Session Law	*Bill #*	*Sponsor*
S.L. 2005-144	**HB 1630**	**Representative Luebke**

AN ACT AUTHORIZING THE DIRECTOR OF THE BUDGET TO CONTINUE EXPENDITURES FOR THE OPERATION OF GOVERNMENT AT THE LEVEL IN EFFECT ON JUNE 30, 2005; EXTENDING THE FINAL MATURITY OF CERTAIN GLOBAL TRANSPARK DEBT FROM JULY 1, 2005, UNTIL JULY 31, 2005; EXTENDING THE SUNSET ON RETIRED TEACHERS RETURNING TO THE CLASSROOM UNTIL JULY 31, 2007; CONFORMING THE STATE ESTATE TAX TO THE FEDERAL ESTATE TAX SUNSET; AND EXTENDING THE SUNSET ON THE ADDITIONAL ONE-HALF CENT STATE SALES AND USE TAX FROM JULY 1, 2005, UNTIL THE 2005 APPROPRIATIONS ACT BECOMES LAW.

OVERVIEW: Part VIII of the act conforms the repeal of the North Carolina estate tax to the repeal of the federal estate tax. Part IX of the act extends the sunset of the additional one-half cent State sales and use tax until the date that the Current Operations and Capital Improvements Appropriations Act of 2005 (hereinafter 2005 Appropriations Act) becomes law, but in no event is the tax extended beyond December 31, 2005.[14]

The remaining parts of the act set out temporary year-end transitional provisions that were in effect until the passage of the 2005 Appropriations Act, extended the maturity date of certain debt of the Global Transpark Authority, and extended the sunset on retired teachers returning to the classroom.[15]

FISCAL IMPACT: The extension of the estate tax sunset is estimated to generate gains to the General Fund of $30.6 million in FY 2005-06 and $121.6 million in FY 2006-07. See the summary of S.L 2005—276 (2005 Appropriations Act) for the fiscal impact of the extension of the one-half cent state sales tax.
(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2005 Session. Available in the Legislative Library.)

EFFECTIVE DATE: Parts VIII and IX of the Act became effective when signed into law by the Governor on June 30, 2005.

ANALYSIS: Part VIII of the act conforms the repeal of the State estate tax to the repeal of the federal estate tax, which is scheduled to become effective for deaths occurring on or after January 1, 2010. The State continues to conform to the increasing federal exemption amounts.[16] The amount of the State estate tax remains at the amount of the State death tax credit allowed under the Internal Revenue Code in 2001. The Governor and the Senate, in Senate Bill 622, also recommended continuing the State estate tax.

North Carolina repealed its inheritance tax in 1998, effective for deaths occurring on or after January 1, 1999. It replaced the inheritance tax with an estate tax that was equivalent to the federal state death tax credit allowed on a federal estate tax return. This type of state estate

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[14] The 2005 Appropriations Act became law on August 13, 2005, and extended the sunset on the additional one-half cent State sales and use tax to July 1, 2007. (See Section 33.1 of S.L. 2005-276).
[15] S.L. 2005-201 extended the maturity date of certain Global Transpark debt to August 31, 2005.
[16] North Carolina conforms to the following federal exemption amounts: 100% exemption for property passing to a surviving spouse; $1.5 million exemption for other estates. Under current federal law, this exemption amount rises to $2 million in 2006, $3.5 million by 2009, and the tax is fully repealed in 2010.

tax was known as a "pick-up" tax because it picked up for the state the amount of federal estate tax that would otherwise be paid to the federal government. In 2001, Congress increased the exclusion amount for the federal estate tax and phased out the state death tax credit over four years by reducing it 25% in 2002, 50% in 2003, and 75% in 2004%, and by repealing it entirely in 2005.

In 2002, the General Assembly enacted legislation not to conform to the phase-out of the state death tax credit. In other words, North Carolina began tying the amount of the State estate tax owed to the federal credit as it existed in 2001 rather than as it currently exists. The 2002 legislation was set to sunset for estates of decedents dying on or after January 1, 2004. S.L. 2003-2004 extended the sunset to July 1, 2005, meaning that the estate tax would continue to be based on the federal credit as it existed in 2001. This act removes the sunset. The result of the removal of the sunset is that so long as there is a federal estate tax, there will be a North Carolina estate tax. The amount of the State estate tax will be equal to the amount of the federal state death tax credit as it existed in 2001.

Part IX of the act extends the sunset on the additional one-half percent State sales and use tax rate to the date that the 2005 Appropriatons Act became law. The General Assembly increased the State sales and use tax rate in S.L. 2001-424 from 4% to 4.5%. This increase was to sunset July 1, 2003. S.L. 2003-284 extended the sunset for two years to July 1, 2005. The 2005 Appropriations Act extends the additional one-half per cent rate to July 1, 2007.

Before 2001, the State sales and use tax rate had last been increased in 1991 from 3% to 4%. The Governor's 2005 budget (House Bill 719) recommended removal of the sunset on the ½% additional State sales and use tax, and the Senate passed his recommendation in Senate Bill 622.

PUBLIC FINANCE CHANGES.

Session Law	*Bill #*	*Sponsor*
S.L. 2005-238	**HB 1117**	**Representative Ross**

AN ACT TO MAKE CHANGES TO STATE AND LOCAL GOVERNMENT FINANCE LAWS AND TO AUTHORIZE PUBLIC HOSPITAL AUTHORITIES TO GRANT MORTGAGES TO FINANCE OR REFINANCE HOSPITAL FACILITIES AND EQUIPMENT.

OVERVIEW: This act makes various amendments to statutes dealing with public finance. The act contains a severability clause so that if any provision of the act is found invalid, the invalidity will not affect other provisions of the act.

FISCAL IMPACT: No impact.
(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2005 Session. Available in the Legislative Library.)

EFFECTIVE DATE: The act became effective August 1, 2005.

ANALYSIS: This act makes various changes to State and local government finance laws.

Project Development Financing. – In 2003, the General Assembly passed an act authorizing the voters of the State to vote in the November 2004 statewide general election on an amendment to the North Carolina Constitution that would allow local governments to finance development within defined districts by issuing tax increment financing bonds without a local referendum. The ballot measure passed. This development tool, known as 'project development financing', allows

local governments to set aside the additional property taxes that are generated by a new investment to pay for public facilities that support that new investment. Under current law, the total land area of the defined district, known as the 'development financing district', may not exceed 5% of the total land area of the unit creating the district. The district also must be comprised of property that is one or more of the following:

- Blighted, deteriorated, deteriorating, undeveloped, or inappropriately developed from the standpoint of sound community development and growth.
- Appropriate for rehabilitation or conservation activities.
- Appropriate for the economic development of the community.

The act provides that land in a district created by a county that subsequently becomes part of a municipality does not count against the five-percent (5%) limit for the municipality unless the municipality has entered into an agreement with the county under which the city taxes on the incremental valuation of the property in the district will secure the bonds issued by the county.[17]

The act makes one other change to the project development financing statutes. Under prior law, units of local government could issue project development financing debt instruments, and agree to repay the debt with any available revenues of the unit, provided the agreement did not constitute a pledge of the unit's taxing power. The act expands the sources of revenue that may be pledged as security for the bond to include revenues to be raised from any special assessment, provided it did not constitute a pledge of the unit's taxing power, and the encumbrance of any real or personal property being financed or improved by the project. Any property so encumbered could be sold in accordance with the encumbering document and would not fall under any disposition of governmental property statutes. The act also allows cities and towns to pledge local sales tax revenues. Those revenues do not constitute a pledge of the taxing power of a city or town because local sales tax is a county tax that is shared with the municipalities, not a tax levied by a city or town.[18]

Revenue Bonds. – The State and units of local government are authorized to issue revenue bonds, but prior law specifically prohibited them from encumbering the related real property. This act allows the State and units of local government, including hospital facilities, to pledge, mortgage, or grant a security interest in real and personal property, whether owned or leased, comprising the utility or public enterprise project affected by the bond issuance. Any property so encumbered could be sold in accordance with the encumbering document and would not fall under any disposition of governmental property statutes. The act authorizes the same encumbrance of property in connection with the issuance of revenue bonds made through the Medical Care Commission that could occur through the Revenue Bond Act. The act also makes a similar change in the NC Clean Water Revolving Loan and Grant Act by permitting an applicant for clean water revolving grants and loans to grant a mortgage on the assets being financed.[19] Local government units and certain non-profit water corporations may apply for clean water revolving grants and loans.

General Changes. – The act makes the following general changes to the State and local finance laws:

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[17] Sections 1, 5, and 12 of the act.
[18] Section 6 of the act.
[19] Sections 4, 11, 13, and 14 of the act.

- Local governments are required to appoint a finance officer to carry out certain statutorily required duties.[20] Under prior law, the finance officer was required to have a performance bond of at least $10,000 and no more than $250,000, payable to the local government. The act increased the minimum bond amount to $50,000 and removed the cap.[21]
- Under prior law, the public notification and hearing requirements for refunding bonds were the same as for the original issuance. The act provides that if refunding bonds do not extend the maturity of, or increase the aggregate debt service on, the debt being refunded, then a new public hearing is not required, the bond order may be introduced and adopted in one day, and various restrictions about installments, issues, series, and redemption do not apply.[22]
- The act removes the requirement that all bonds of a particular maturity must bear interest at the same rate and clarifies that the interest rate restrictions do not apply to private negotiated sales.[23]
- The act eliminates the 2% deposit on the bids for general obligation bonds and in its place permits the Local Government Commission to set an appropriate bid deposit or to determine no bid deposit is required.[24]
- Bonds sold at public sale must be awarded to the bidder offering to purchase the bonds at the lowest interest cost. The act replaces the current statutory language used to determine the lowest interest cost for bond bid purposes with Local Government Commission authority to establish the appropriate calculation method in the notice of sale.[25]
- The act replaces the antiquated system for destroying cancelled bonds. It permits cancelled bonds to be destroyed by being marked cancelled in the manner determined by the finance officer with an entry of the destruction or cancellation entered in the government's official records. Under the prior law, the cancelled debt instrument had to be burned or shredded and the appropriate entry made in a 'substantially bound book'.[26]
- Lastly, the act expands the purposes for which the North Carolina Capital Facilities Financing Agency and local industrial development authorities may issue bonds to include museums and orphanages and similar housing facilities for children or disadvantaged or disabled persons.[27]

EXTEND JDIG AND BILL LEE ACT.

Session Law	*Bill #*	*Sponsor*
S.L. 2005-241	**HB 1004**	**Rep. Gibson, Grady**

[20] G.S. 159-24 and G.S. 159-25.
[21] Section 2 of the act.
[22] Section 3 of the act.
[23] Section 7 of the act.
[24] Section 7 of the act.
[25] Section 8 of the act.
[26] Section 9 of the act.
[27] Section 10 of the act.

AN ACT TO EXTEND THE WILLIAM S. LEE QUALITY JOBS AND BUSINESS EXPANSION ACT AND THE JOB DEVELOPMENT INVESTMENT GRANT PROGRAM; TO ALTER THE MANNER IN WHICH ENTERPRISE TIERS ARE DESIGNATED; TO AMEND THE HEALTH INSURANCE REQUIREMENTS FOR THE JOB DEVELOPMENT INVESTMENT GRANT PROGRAM; AND TO CREATE AN ECONOMIC DEVELOPMENT OVERSIGHT COMMITTEE TO PERFORM A COMPREHENSIVE STUDY OF THE ECONOMIC DEVELOPMENT INCENTIVES.

OVERVIEW: This act makes the following changes to the William S. Lee Quality Jobs and Business Expansion Act (hereinafter the Bill Lee Act) and the Job Development Investment Grant Program (hereinafter the JDIG Program):

- Extends the sunset for the Bill Lee Act and the JDIG Program until January 1, 2008. For certain projects located in development zones, the sunset of the Bill Lee Act is extended until January 1, 2010.
- Amends and adds exceptions to the tier designation formula under the Bill Lee Act as follows:
    - Adds an exception to designate a county as a tier one area if the county's rate of unemployment was one of the ten highest in the State for the most recent 12-month period preceding the designation.
    - Amends the exception for certain small counties that have a population of less than 12,000 and that meet a certain poverty level, by requiring that the counties only meet the population requirement to be designated a tier one area.
- Amends the JDIG Program so that an eligible business no longer is required to provide health insurance for **all** full-time employees. The eligible business must provide health insurance only to a full-time employee who earns less than $150,000 in taxable compensation annually or three and one-half times the annualized average wage for all private insured employers in the State employing between 250 and 1,000 people.
- Creates an Economic Development Oversight Committee.

FISCAL IMPACT: Changes to the Bill Lee Act are estimated to reduce General Fund revenues by $2.03 million in FY 2006-07, $7.22 million in FY 2007-08, $5.47 million in FY 2008-09, and $5.64 million in FY 2009-10. The extension of the JDIG sunset is estimated to reduce General Fund revenues by $4.50 million in FY 2006-07, $9 million in FY 2007-08, $9 million in FY 2008-09, and $6 million in FY 2009-10.
(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2005 Session. Available in the Legislative Library.)

EFFECTIVE DATE: This act became effective when signed into law by the Governor on July 29, 2005. The sections of the act amending and adding exceptions to the tier designation formula of the Bill Lee Act apply to designations made on or after July 29, 2005.

ANALYSIS:

Extension of Sunsets for Bill Lee Act and JDIG Program

This act extends the sunsets on both the Bill Lee Act and the JDIG Program generally from January 1, 2006 to January 1, 2008.[28] In addition, the act extends the Bill Lee Act until January 1, 2010, for projects located in development zones if all of the following conditions[29] are met:

- Before January 1, 2006, the taxpayer must sign a letter of commitment with the Department of Commerce describing the proposed new or expanding project.
- Before January 1, 2006, the Secretary of Commerce must make a written determination that the taxpayer is expected to place in service at least $10 million of new machinery and equipment in a development zone over a three-year period and that the taxpayer will create at least 300 new jobs at the location over a three-year period.
- Before January 1, 2006, the taxpayer must place in service at least $4 million of real property and machinery and equipment in service at the location and must create at least 20 new jobs.

In 1998, the General Assembly amended the Bill Lee Act to provide additional incentives for businesses that locate or expand in development zones, which are economically distressed areas located within cities. In order to be designated as a development zone by the Department of Commerce, the area must satisfy all of the following conditions: (1) every census tract or block group in the zone is located at least partially in a city with a population of at least 5,000, (2) the zone has a population of at least 1,000, (3) more than 20% of the population of the zone is below the poverty level, (4) every census tract and census block group in the zone has more than 10% of its population below the poverty level, or is immediately adjacent to a tract or group that has more than 20% of its population below the poverty level, and (5) no census tract or block group in the zone is located in another development zone. Designation as a development zone is effective for two years.

Location in a development zone leads to enhanced tax incentives. For example, if a business locates in a development zone, its maximum worker training credit is $1,000 rather than $500, it receives an additional $4,000 per job on its jobs tax credit, and the credit for investing in machinery and equipment is calculated as if the zone were a tier one county. Finally, a business

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[28] There are several exceptions to the 2006 sunset date: Interstate air couriers are eligible to claim the credits for business activity that occurs on or before January 1, 2010, provided that the interstate air courier entered into a real estate lease on or before January 1, 2006, with an airport authority that provides for the lease of at least 100 acres of land for a term of at least 15 years. Taxpayers that qualify as "eligible major industries" before January 1, 2006, are also allowed to claim credits for business activity that occurs on or before January 1, 2010. A taxpayer is an eligible major industry if it will invest at least $100 million in acquiring, constructing, and equipping a facility and it is engaged in bioprocessing, the manufacture or distribution of pharmaceuticals or medicines, aircraft manufacturing, computer manufacturing, motor vehicle manufacturing, or semiconductor manufacturing. Also the credit for research and development under the Bill Lee Act would still expire effective January 1, 2006. During the 2004 Regular Session, the research and development credit under the Bill Lee Act was replaced with a stand-alone credit for research and development under Article 3F of Chapter 105. (See Part 32D of S.L. 2004-124) This stand-alone credit sunsets January 1, 2009.

[29] Only two projects qualified for this extension at the time this act was enacted: The Cheesecake Factory in Nash County and the Dole plant in Gaston County.

located in a development zone does not have to meet a wage standard to be eligible for the credits.

Exceptions to Tier Formula in Bill Lee Act[30]

Under the Bill Lee Act, counties are divided into five enterprise tiers based on the unemployment rate, per capita income, and population growth of the county. For many of the credits, the lower the tier of a county, the more favorable the incentive. By December 31 of each year, the Department of Commerce is required to assign a tier designation to each of the 100 counties in the State. In order to make these assignments, the Department of Commerce must rank all 100 counties based on the following factors: the rank of the county in a ranking of counties by average rate of unemployment over the preceding 12 months from lowest to highest, the rank of the county in a ranking of counties by average per capita income over the preceding 12 months from highest to lowest, and the rank of the county in a ranking of counties by percentage growth in population over the preceding 12 months from highest to lowest. Each of these factors is given equal weight. The Secretary of Commerce is required to use the latest data available in making these calculations. Counties with one of the 10 highest rankings are designated enterprise tier one, the next 15 counties are enterprise tier two, the next 25 counties are enterprise tier three, the next 25 counties are enterprise tier four, and the remaining counties are enterprise tier five.

There are several exceptions to the tier formula. Once exception provides that any county that has a population of less than 12,000 and more than 16% of its population living below the federal poverty level is automatically a tier one county. This act eliminates the requirement related to the percent living below the poverty level. If this provision had been in effect for the 2005 designations, two counties would have been affected: Camden and Clay Counties would have been designated as enterprise tier one areas rather than enterprise tier three areas.

This act also creates a new exception for counties with particularly high rates of unemployment. Any county whose rate of unemployment was one of the ten highest in the State for the most recent 12-month period preceding the designation is automatically designated an enterprise tier one area. If this new exception had been in effect for the 2005 designation, five counties would have been affected: Anson, Cleveland, Rockingham, and Rutherford Counties would have fallen from tier two to tier one; Wilson County would have fallen from tier three to tier one.

Health Insurance Requirement for JDIG Program

In 2002, the General Assembly created a new economic development tool for new and expanding businesses in North Carolina, the Job Development Investment Grant (JDIG) Program. The JDIG Program is used to attract businesses to the State by allowing a five-member committee to award grants to businesses. The grants may be awarded over as many as 12 years and the amounts of the grants are based on income tax withholdings from new jobs created by the businesses. The committee may enter into no more than 25 agreements per calendar year and may commit no more than $15 million in any fiscal year under all agreements entered into during a single calendar year. In order to be eligible for a grant under the JDIG Program, a business must provide health insurance for all full-time jobs associated with the project. The test is the same as under the Bill Lee Act – the business must, for all full-time employees of the project, pay at least 50% of the premiums for health insurance that meets at

[30] S.L. 2005-406 also amends the tier designation formula by allowing certain industrial parks located in higher-tiered counties to be treated as if they were located in an enterprise tier one area if the parks meet conditions related to government ownership, size, population of the counties, and Medicaid eligibility within the counties.

least the minimum provisions of the basic health care plan of coverage recommended by the Small Employer Carrier Committee.

This act eliminates the requirement that the business provide health insurance for any individual whose taxable compensation from the business exceeds the greater of $150,000 on an annualized basis or 3.5 times the average wage for all private insured employers in the State employing between 250 and 1,000 people.

Creation of Economic Development Oversight Committee.

This act creates an Economic Development Oversight Committee.[31] This standing committee consists of twelve members: six appointed by the Speaker of the House of Representatives and six appointed by the President Pro Tempore of the Senate. The act directs the Committee to study the budgets, programs, and policies of various State, regional, and local entities involved with economic development; to analyze legislation from other states regarding economic development; and to analyze proposals of the Economic Development Board. Before the 2006 Regular Session, the Committee must complete a comprehensive study of the Bill Lee Act and JDIG Program. The Committee is also required to hold at least one joint meeting with the Revenue Laws Study Committee before issuing a report on the comprehensive study. The act states that it is the intent of the General Assembly to replace the Bill Lee Act and to revamp the JDIG Program based on the recommendations of the Committee.

2005 APPROPRIATIONS ACT.

Session Law	*Bill #*	*Sponsor*
S.L. 2005-276	**SB 622**	**Senator Garrou**

AN ACT TO MAKE BASE BUDGET APPROPRIATIONS FOR CURRENT OPERATIONS OF STATE DEPARTMENTS, INSTITUTIONS, AND AGENCIES, AND FOR OTHER PURPOSES.

OVERVIEW, EFFECTIVE DATES, AND FISCAL IMPACT:

Part	Description and Effective Dates	Fiscal Impact
7	**LEA Sales Tax Refund Reporting & Redirect Refundable Sales to State Public School Fund**	
	Section 7.27 authorizes the Department of Revenue to release sales tax refund data for individual LEAs.	No impact.
	Section 7.51 redirects sales and use tax refunds payable to LEAs to the State Public School Fund.	$33,300,000 recurring General Fund Revenue, beginning with the 2006-07 fiscal year.
8	**Extend the Sunset on Training & Reemployment Contributions made by Employers**	
	Section 8.8 extends for an additional five years the expiration of a tax, known as a	No impact.

[31] House Bill 1365, introduced by Rep. Daughtridge, also established an Economic Development Oversight Committee. This bill was in the House Rules Committee at the end of the Session.

	"training and reemployment contribution" paid by employers in lieu of part of the unemployment taxes they would otherwise owe.	
11	**Increase Funds for North Carolina Grape Growers Council** Section 11.4 expands the quarterly distribution of a portion of the excise tax on wine to the North Carolina Grape Growers Council by raising the annual cap from $350,000 to $500,000, effective October 1, 2005.	
22	**Department of Revenue Debt Fee for Taxpayer Locater Services and Collection and Property Tax Commission Per Diem** Section 22.1 adds three more purposes to the list of purposes for which the collection assistance fee may be used. Section 22.5 authorizes the Property Tax Commission to set the salary for its members, effective September 1, 2005.	
33	**Sales Tax Changes** This part makes the following changes to the State sales and use tax laws:	
	• Section 33.1 extends the one-half cent State sales tax to July 1, 2007, effective August 13, 2005.	FY 2005-06 $417.1 million gain FY 2006-07 $462.7 million gain FY 2007-08 $31.6 million gain
	• Section 33.11 taxes railway cars and locomotives at the general rate (was 3% State rate with cap of $1,500 per item), effective January 1, 2006. Section 33.12 provides interstate carriers a refund of a portion of the taxes paid.	Minimal fiscal impact expected
	• Section 33.4 taxes telecommunications at the combined general rate (was 6%), effective October 1, 2005.	FY 2005-06 $32.1 million gain. The gain is estimated at $51.7 million for a full fiscal year.
	• Section 33.6 includes voicemail as part of the gross receipts of telecommunications service, effective October 1, 2005.	Minimal fiscal impact.
	• Section 33.4 taxes direct-to-home satellite service at combined general rate (was 5%), effective October 1, 2005.	FY 2005-06 $6.5 million gain. The gain is estimated at $10.5 million for a full fiscal year.

	• Sections 33.4 and 33.14 tax cable service at combined general rate, and allow a cable service provider a credit for the local franchise taxes paid on cable service (was no sales tax), effective January 1, 2006.	FY 2005-06 $10.9 million gain FY 2006-07 $26.1 million gain
	• Section 33.4 taxes satellite digital audio radio service at general rate (was no sales tax), effective January 1, 2006.	No fiscal information available, but a revenue gain is expected in future years.
	• Section 33.4 taxes spirituous liquor at combined general rate (was 6%), effective October 1, 2005.	FY 2005-06 $2.9 million gain
	• Section 33.10 taxes candy at general rate (was exempt), effective October 1, 2005.[32]	FY 2005-06 $9.8 million gain FY 2006-07 $15.8 million gain
	• Section 33.4 taxes mobile classrooms and mobile offices at the general rate (was taxed at 3% State rate with cap of $1,500 per item), effective January 1, 2006.	FY 2005-06 $0.1 million gain FY 2006-07 $0.3 million gain

	• Section 33.9 exempts the following items currently taxed at special 1% State rate, effective January 1, 2006:
	  ○ Horses and mules sold to farmers
	  ○ Animal semen
	  ○ Fuel, other than electricity, sold to farmers for farm purposes, to manufacturers, and to laundries and dry cleaners
	  ○ Wrapping paper, cartons, and supplies sold to freezer locker plants
		The exemption of items taxed at 1% is expected to reduce the General Fund by $0.95 million in FY 2005-06 and thereafter by $2.0 million annually.

[32] Prior to 2003, candy was subject to State and local sales tax unless it was purchased for home consumption. S.L. 2003-284 exempted candy from sales tax. The taxation of candy brings it in line with the taxation of soft drinks.

	• Section 33.9 exempts the following items currently taxed at the special State rate of 1%, with an $80 cap per item, effective January 1, 2006: ○ Sales to farmers of machinery, attachments and repair parts for the machinery, and lubricants applied to the machinery. ○ Sales to farmers of containers for use in planting, harvesting, marketing, packaging, or transporting farm products. ○ Bulk tobacco barns or racks, parts, and accessories attached to the barns. ○ Grain, feed, or soybean storage facilities.	The exemption of sales to farmers of machinery and containers and of sales of storage facilities and tobacco barns is estimated to reduce the General Fund by $1.5 million for FY 2005-06 and thereafter, by $3.1 million annually.
	○ Sales to laundries and dry cleaners of machinery, parts, and accessories attached to the machinery. ○ Sales to an interstate passenger air carrier of aircraft simulators for flight crew training. ○ Sales to an interstate air courier of materials handling equipment and racking systems used at an airport or in a warehouse or distribution facility. ○ Central office equipment, switchboard equipment, private branch exchange equipment, and terminal equipment sold to telephone companies. ○ Towers and broadcasting equipment sold to a radio or television company licensed by the FCC; and broadcasting equipment (excluding cable) sold to a cable service provider.	The exemption of sales of equipment to laundries, telephone companies, radio and television companies, and air couriers is estimated to reduce the General Fund by $0.9 million for FY 2005-06 and thereafter, by $2.0 million annually.

	• Section 33.9 exempts funeral services, but taxes tangible property such as caskets and monuments at the general rate, effective January 1, 2006. Current law exempts funeral expenses, including coffins and caskets, not to exceed $1,500. • Sections 33.8 and 33.24 make the use tax applicable to taxable services sourced to the State, effective October 1, 2005, and extend the sunset on the use tax line item on the individual income tax return from January 1, 2005 to January 1, 2010. • Section 33.3 adds new definitions to the sales tax laws in order to conform to the Streamlined Sales and Use Tax Agreement, effective October 1, 2005. <u>Revenue Laws Study Committee</u> Section 33.32 directs the Revenue Laws Study Committee to study the following issues and make a final report to the 2007 General Assembly: ○ Equity of taxation on video, cable, satellite, and data service providers. ○ Impact of taxing maintenance agreements. (It is the intent of the General Assembly to apply the sales and use tax to maintenance agreements beginning July 1, 2006). Section 33.33 reenacts and limits S.L. 2004-123 so that it applies to Dare County only. The 2004 legislation authorized counties to levy an additional 1% sales and use tax for beach nourishment. The legislation, as the title indicates, was meant to apply to Dare County only.	FY 2005-06 $1.7 million gain FY 2006-07 $2.7 million gain
34	**Tobacco Tax Rate Changes** Effective September 1, 2005, increased the tax on cigarettes from 5 cents a pack to 30 cents a pack. Effective July 1, 2006,	FY 2005-06 $117.2 million gain FY 2006-07 $187.3 million gain FY 2007-08 $184.0 million gain FY 2008-09 $179.1 million gain

	increases the tax on cigarettes to 35 cents a pack. Effective September 1, 2005, increased the tax on other tobacco products from 2% to 3%. Effective August 13, 2005, authorized a tobacco product manufacturer that elects to place funds into a qualified escrow fund in lieu of participating in the Master Settlement Agreement to assign its interest in the funds to the benefit of the State.	FY 2009-10 $173.7 million gain FY 2005-06 $1.6 million gain FY 2006-07 $2.1 million gain FY 2007-08 $2.2 million gain FY 2008-09 $2.3 million gain FY 2009-10 $2.4 million gain
35	**IRC Update** Effective August 13, 2005, changed the State tax law reference to the Internal Revenue Code from May 1, 2004, to January 1, 2005. However, any amendments to the Internal Revenue Code enacted after May 1, 2004, that would have increased North Carolina taxable income for the 2004 taxable year are effective for 2005 taxable year.	The partial conformance to the Code results in a loss to the General Fund of $8 million for FY 2005-06 and $10.7 million for FY 2006-07.
36	**Individual Income Tax Changes** Extends the 8.25% upper-income individual income tax rate for two more taxable years: 2006 and 2007.	FY 2005-06 $39.8 million gain FY 2006-07 $89.7 million gain FY 2007-08 $50.18 million gain
38	**Corporate, Excise, and Insurance Tax Changes** <u>Equalize Gross Premiums Tax</u> Effective for taxable years beginning on or after January 1, 2007, taxes health maintenance organizations (HMOs) at the general gross premiums tax rate of 1.9% and repeals the special 1% rate for HMOs.	FY 2005-06 no impact FY 2006-07 $13.4 million gain FY 2007-08 $3.94 million gain FY 2008-09 $13.4 million gain FY 2009-10 $13.4 million gain
39	**Tax Incentives/Film Industry Jobs Incentives** <u>Film Industry Jobs Incentives</u> Effective for taxable years beginning on or after January 1, 2005, provides a refundable income tax credit equal to 15% of the production expenses for film and television production companies that spend at least $250,000 in North Carolina in connection with certain productions.	FY 2005-06 $3.5 million loss FY 2006-07 $3.5 million loss FY 2007-08 $3.5 million loss FY 2008-09 $3.5 million loss FY 2009-10 $3.5 million loss

(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2005 Session. Available in the Legislative Library.)

ANALYSIS: This act is known as the 'Current Operations and Capital Improvements Appropriations Act of 2005.' The act contains several tax provisions that are summarized below.

Part 7: Public Schools

Part VII of the act contains two provisions related to the sales and use tax refund allowed to local school administrative units. LEAs are among the list of entities that may apply to the Secretary of Revenue for an annual refund of State and local sales and use taxes paid by it on direct purchases of tangible personal property and services, other than electricity and telecommunications service. A request must be in writing and is due within six months after the end of the LEA's fiscal year.

The first provision can be found in Section 7.27. It allows the Department of Revenue to release sales tax refund information on a per LEA basis and it makes a corresponding change in the tax secrecy statute. This information will be useful in providing complete budget oversight. Since the refund is received outside of the appropriations and budgetary process, the LEA could spend the money in whatever manner it chose. The act requires the Department to make an annual report to the Department of Public Instruction and to the Fiscal Research Division of the General Assembly by March 1 of the amount of refunds claimed by taxpayer. The act directs the Department to also provide this information for the past three fiscal years: 2002-03, 2003-04, and 2004-05.

The second provision can be found in Section 7.51. It redirects estimated State sales tax revenues refundable to LEAs to the State Public School Fund for allotment through State position, dollar, and categorical allotments. The effect of this provision is to funnel all State monies for public education through the budgetary process by eliminating the State monies going directly to LEAs through the refund process.

The provision accomplishes this redirection in three steps:

- It repeals the ability of individual LEAs to obtain an annual refund of the State and local sales and use tax monies paid, effective July 1, 2005, and applicable to sales made on or after that date.[33] LEAs have had the ability to request an annual refund of State and local sales and use taxes paid since July 1, 1998.[34] The provision also repeals the ability of school board cooperatives to obtain a refund; they have had the ability to request annual refunds since July 1, 2003.[35] The LEAs will be able to obtain a refund for sales and use taxes paid by them during the fiscal year 2004-05. The request for the refund must be made on or before December 31, 2005, and the amount will be refunded during fiscal year 2005-06.
- For fiscal year 2006-07, the provision directs the Secretary of Revenue to transfer quarterly a calculated amount from the State sales and use tax net collections to the State Public School Fund. The quarterly amount will be equal to one-fourth of the amount

[33] The intent of the legislation, as reflected by the Committee Report, was to repeal the ability of school boards to obtain a refund of State sales and use taxes paid, not State and local. It is anticipated that a provision will be introduced in the 2006 legislative session to reinstate the refund of local sales and use taxes.

[34] S.L. 1998-212.

[35] S.L. 2003-431.

refunded to LEAs and school board cooperatives[36] during the 2005-06 fiscal year plus or minus the percentage of that amount by which the total collection of State sales and use tax increased or decreased during the preceding fiscal year. The Fiscal Research Division estimates that the total amount of this annual earmarking will be $33,000,000.[37]

- For subsequent fiscal years, the provision directs the Secretary to transfer quarterly an amount equal to one-fourth of the amount refunded to LEAs and school board cooperatives during the preceding fiscal year plus or minus the percentage of that amount by which the total collection of State sales and use taxes increased or decreased during the preceding fiscal year.

Part 8: Community Colleges

In 1999, the General Assembly temporarily reduced unemployment insurance taxes for most employers by 20% and levied a corresponding contribution to be used for enhanced reemployment services and worker training programs, effective January 1, 2000.[38] While the unemployment insurance taxes fund the unemployment insurance fund, the training and reemployment contribution is credited to a special account in the State Treasury to be appropriated annually by the General Assembly to the Department of Community Colleges for various worker-training programs. Thus, the training and reemployment contribution program has the effect of redirecting payments from the unemployment insurance fund to appropriations for State worker training programs The training and reemployment contribution program was originally set to expire in 2002. S.L. 2001-424 extended the expiration date to 2006. Section 8.8 of this act extends the sunset date to 2011.

The law, as written in 1999, automatically suspends the training and reemployment contribution any time the unemployment insurance fund falls to $900 million or less or any time the State unemployment rate rises above 4.3%.[39] The training and reemployment contribution was suspended shortly after it was enacted because the unemployment insurance fund balance fell below $900 million. The unemployment insurance fund currently has a balance of roughly $20 million and the State unemployment rate is 5.1%.

Part 11: Department of Agriculture and Consumer Services

The first $350,000 of the net proceeds of the excise tax on fortified and unfortified wine is credited to the Department of Agriculture and Consumer Services.[40] The funds credited to the Department from this tax must be allocated to the North Carolina Grape Growers Council and used to promote the North Carolina grape and wine industry and to contract for research and development services to improve viticultural and enological practices in North Carolina. If any of the earmarked funds are not expended during the fiscal year, they do not revert to the General Fund but remain available to the Grape Growers Council.

Section 11.4 of the act expands the quarterly distribution of a portion of the excise tax on wine to the North Carolina Grape Growers Council by raising the annual cap from $350,000 to

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[36] S.L. 2003-345 corrected a statutory reference made in this provision of the act.
[37] This dollar amount reflects the amount of State sales and use taxes paid by LEAs, not the local sales and use taxes paid by them.
[38] S.L. 1999-321.
[39] G.S. 96-6.1.
[40] S.L. 2005-380 transferred the North Carolina Grape Growers Council from the Department of Agriculture and Consumer Services to the Department of Commerce.

$500,000. Prior to 2001, the Council received 94% of the net tax proceeds from the excise tax on unfortified wine and 95% of the tax collected on fortified wine, up to $175,000 a year. In 2001, the General Assembly allocated 100% of the net tax revenues from unfortified and fortified wine to the Council and increased the cap from $175,000 to $350,000 in 2001.[41] The amount distributed to the Council reached the $350,000 cap in fiscal year 2002-03. The net proceeds from the tax in fiscal year 2004-05, and the amount the Council would have received but for the cap, totaled $473,343.

Part 22: Department of Revenue

In 2001, the General Assembly established a system under which the cost of collecting overdue tax debts is to be borne by the delinquent taxpayers, not by the taxpayers who pay their taxes on time. The collection assistance fee is 20% of the overdue tax debt and is a receipt of the Department.[42] The proceeds of the fee are credited to a special, non-reverting account to be used only for collecting overdue tax debts. The Department of Revenue may apply the fee proceeds to pay contractors for collecting tax debts and to pay the fee charged by the federal government for collecting tax debts by offset. The remaining proceeds of the fee may be spent for collecting overdue tax debts only pursuant to appropriation by the General Assembly. In 2004, the General Assembly enacted legislation stating that the proceeds of the fee could not be used for any purpose that is not directly and primarily related to collecting overdue tax debts. In addition to the two expenditures specifically authorized in 2001, the General Assembly added 'taxpayer locater services' to the list of purposes directly and primarily related to collecting overdue tax debts.

Section 22.1 of this act adds three more purposes to which the fee proceeds may be applied:

- Postage or other delivery charges for correspondence relating to collecting overdue tax debts.
- Operating expenses for Project Collection Tax and the Taxpayer Assistance Call Center.
- Expenses of the Examination and Collection Division relating to collecting overdue tax debts.

The provision also requires the Department to account for all expenditures using accounting procedures that clearly distinguish costs allocable to collecting overdue tax debts from costs allocable to other purposes and it must demonstrate that none of the fee proceeds are used for any purpose other than collecting overdue tax debts. This section became effective July 1, 2005.

Section 22.5 authorizes the Property Tax Commission to set the salary for its members, effective September 1, 2005. Under prior law, the Commission members were compensated $200 a day for their work on the Commission.[43] In the fourth edition of Senate Bill 622, this provision changed the salary of the Commission members from $200 a day to $400 a day and it also set the salary for the chair of the Commission at $450 a day. Although the final budget act did not set

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[41] S.L. 2001-475.

[42] Section 22.6 of S.L. 2005-276 amended the law to provide that the amount of the collection assistance fee would be the actual cost of collection, not to exceed 20% of the amount of the overdue tax debt. However, section 37 of S.L. 2005-345 subsequently repealed this section, leaving the amount of the collection assistance fee at 20% of the amount of the overdue tax debt.

[43] S.L. 2000-67 provided that members of the Commission would receive travel, subsistence, and salary while being trained and clarified those members should receive salary and reimbursement while deciding, as well as hearing, cases.

the salaries at this amount, S.L. 2005-345, 'Modify 2005 Budget Appropriations Act', amended this act to appropriate additional funds to the Department of Revenue to be used to pay the increased salaries of the Commission members at that amount.

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

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

Part 33: Sales Tax Changes

Part 33 makes a number of changes to the sales tax laws that are necessary to conform to the Streamlined Sales and Use Tax Agreement. 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 Project began in March 2000, and has the goal of achieving 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. On July 1, 2005, eleven states, including North Carolina, were determined to be in substantial compliance with terms of the Agreement. The Agreement becomes effective when at least 10 states representing 20% of the population of all states with a sales tax are in compliance with the provisions of the Agreement. As of October 2005, these requirements were met and the Agreement became effective.

Over the past several years, the Revenue Laws Study Committee has recommended, and the General Assembly has enacted, changes to North Carolina sales tax laws to bring it into compliance with the Agreement. As set out in the OVERVIEW, the act makes the following changes to the sales and use tax laws:

- Section 33.3 defines a number of terms. "Combined general rate" is defined as the State's general rate of tax plus the sum of the rates of the local sales and use taxes. The act defines "Streamlined Agreement" and conforms the definition of "food" to the Agreement by removing "alcoholic beverage" from the definition of food. The act also defines the terms "cable service" and "satellite digital audio radio service".

- Amends the sales tax holiday statute to include definitions for "computer supplies" and "school supplies". A State has the option of allowing a sales tax holiday, but the items included in the holiday must be defined terms under the Agreement. The act includes computer supplies in the sales tax holiday. Computer supplies include computer storage media, printers, printer supplies, hand-held electronic schedulers, and personal digital assistants. Prior to August 2004, the State's sales tax holiday included most of these

items. The General Assembly changed the law in 2003 to except these items from the holiday in 2004, in conformity with the Streamlined Agreement. Section 33.11, based upon amendments to the Agreement in November 2004, expands the sales tax holiday to include these items once again so long as the sales price does not exceed $250.

- Sections 33.4 and 33.9 amend the taxation of a number of items as set out in the OVERVIEW by either exempting the item from the sales tax or taxing the item at the combined general rate. These changes satisfy the requirement of the Streamlined Agreement that states must have one tax rate with no caps or thresholds.

- Sections 33.20 and 33.21 expand Article 5F of Chapter 105 to provide that the privilege tax will apply to manufacturing fuel and certain machinery and equipment, effective January 1, 2006. The 2001 General Assembly enacted Article 5F in response to the requirement of the Streamlined Agreement that states must simplify their sales tax rates. The 2001 legislation, which becomes effective January 1, 2006, repealed the 1% sales tax rate and $80 cap imposed on mill machinery and replaced it with a privilege tax having the same rate. Sections 33.20 and 33.21 of the act continue the sales tax rate simplification requirement by imposing a 1% privilege tax on a manufacturing industry or plant that purchases fuel, other than electricity or piped natural gas, to operate the industry or plant. The act also imposes a 1% privilege tax with a cap of $80 per article on a major recycling facility that purchases certain personal property used at the facility. The privilege tax becomes effective January 1, 2006, and replaces the current sales tax imposed on these taxpayers. There will be no fiscal impact because the privilege tax rates will be the same as the current sales and use tax rates. The change from a sales tax to a privilege tax means that retailers are not responsible for collecting and remitting the tax.

- Section 33.13 clarifies the effective dates for sales tax rate increases and decreases on services, effective October 1, 2005. For a rate increase, the new rate applies to the billing period that starts on or after the effective date. For a rate decrease, the new rate applies to bills rendered on or after the effective date. For prepayments of telecommunications and direct-to-home satellite services, the billing period starts on or after November 1, 2005. For prepayments of satellite digital audio radio services, the first billing period starts on or after February 1, 2006.

- Section 33.15 conforms the statutory language in G.S. 105-164.28 to the information actually requested on a certificate of resale, effective October 1, 2005.

- Section 33.17 provides an amnesty provision as required by the Streamlined Sales Tax Agreement for sellers who register with the State within 12 months after the State becomes a member of the Agreement, effective October 1, 2005.

- Section 33.18 clarifies that a seller who relies on the Secretary of Revenue for information concerning the boundaries of taxing jurisdictions and the tax rates applicable to those jurisdictions is not liable for any underpayments of tax attributable to erroneous information provided by the Secretary, effective October 1, 2005.

- Sections 33.8 and 33.24 provide that the use tax applies to taxable services sourced to the State, effective October 1, 2005, and extend the sunset on the use tax line item on the individual income tax return from January 1, 2005 to January 1, 2010. The use tax is owed by the consumer, and unlike sales tax, the consumer must remit it to the State. To simplify use tax collection, the General Assembly established an annual filing

period in 1997 for the payment of use taxes owed by consumers on mail order and other out-of-state purchases. In 1999, it simplified use tax collection by providing that the use tax will be paid on taxpayers' income tax returns. In 2000, the General Assembly sunset this provision in anticipation that use tax collection would be handled by retailers by 2003, as a result of the Streamlined Sales Tax Agreement. The 2003 sunset was overly optimistic. The General Assembly extended the sunset to 2005 in S.L. 2003-284. The act extends it for five more years.

Part 34: Tobacco Tax Changes

Part 34 makes the following three changes to the tobacco tax:

- Effective September 1, 2005, it increased the tax on cigarettes from five cents a pack to 30 cents a pack. Effective July 1, 2006, it increases the tax on cigarettes an additional five cents to 35 cents a pack. The General Assembly last increased the cigarette tax in 1991 from two cents a pack to five cents a pack. The Governor, in his 2005 budget, recommended increasing the tax on cigarettes from five cents a pack to 40 cents a pack from the period between September 1, 2005, and June 30, 2006, and then to 50 cents a pack.
- Effective August 13, 2005, it increased the tax on other tobacco products, such as cigars and snuff, from 2% of the cost price of the product to 3%. The General Assembly first imposed a tax on other tobacco products in 1991 at the rate of 2%. The Governor, in his 2005 budget, recommended increasing the tax from 2% to 15% for the period between September 1, 2005 and June 30, 2006, and then to 18%.
- Effective August 13, 2005, it authorized a tobacco product manufacturer that elected to place funds into a qualified escrow fund in lieu of participating in the Master Settlement Agreement, to assign its interest in the funds to the benefit of the State. Under G.S. 66-291, a tobacco product manufacturer that places funds in escrow is allowed to receive the interest or other appreciation on such funds as earned. This act would allow the manufacturer to assign its interest in the funds, including any earning and appreciation in the escrow account, to the benefit of the State. The assignment is irrevocable and must be in writing. The benefit of this legislation is that a nonparticipating manufacturer that makes an assignment can claim an income tax deduction. The act provides that this legislative authorization is repealed and any assignment of the funds is void if (1) a court finds the new legislation invalid or unenforceable, or (2) a court finds that the new legislation would subject participating manufacturers under the Master Settlement Agreement to a nonparticipating manufacturer adjustment under the Agreement.

Part 35: IRC Update

North Carolina's tax law tracks many provisions of the federal Internal Revenue Code, by reference to the Code.[44] The General Assembly determines each year whether to update its reference to the Internal Revenue Code.[45] Updating the Internal Revenue Code reference makes

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[44] 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.

[45] 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

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.

Part 35 of this act changed the reference date from May 1, 2004 to January 1, 2005. Changing the reference date to January 1, 2005, incorporates federal changes made in the Working Families Tax Relief Act of 2004 (P.L. 108-311) and the American Jobs Creation Act of 2004 (P.L. 108-357). In addition, in early 2005 Congress enacted an act to enhance the tax benefit for certain charitable contributions made in January 2005 for tsunami relief (P.L. 109-1). That act did not amend the Code, but rather used uncodified language to bring about that result. The 2005 Appropriations Act conforms to that legislation as well. A detailed summary of these federal tax law changes is set out below:

Working Families Tax Relief Act (WFTRA) of 2004 (P.L. 108-311)

The Working Families Tax Relief Act of 2004 was signed into law by President Bush on October 4, 2004. Despite its title, the act provides tax benefits for businesses as well as individuals and families. The following features of the act are important for State tax purposes:

- *Creation of a more uniform definition of "child" throughout the Code starting with the 2005 taxable year*. At the federal level, the definition of "child" is important in five areas: the dependency exemption, the child credit, the earned income credit, the dependent care credit, and head of household filing status. The WFTRA creates a more uniform definition of "child" that applies to each of these areas. Under the new definition, a child is a qualifying child if the child satisfies three separate conditions. First, the child must have the same principal place of abode as the taxpayer for more than one half the tax year (residency test). Temporary absences due to special circumstances are not included. Second, the child must be the child, stepchild, sibling, stepsibling, or a descendant of any of these relations of the taxpayer (relationship test). Third, the child must satisfy an age condition to be deemed a qualifying child. In general, a child must be under age 19, or under age 24 if a full-time student, to be a qualifying child. However, lower age limits were retained for the dependent care credit (under 13 years of age unless disabled) and the child tax credit (under 17 years of age). For State tax purposes, the changes are important in so far as they relate to the dependency exemption, the child tax credit, and head of household filing status. The new definition of qualifying child for the dependency exemption may result in a change of status of some children – where the new law has a residency test, the old law had a support test (the taxpayer claiming the child as a dependent had to provide at least 50% of the child's support). For the federal child tax credit, some taxpayers may become eligible to claim the credit due to the elimination of some restrictions related to foster children. This is important because eligibility for the State child tax credit is dependent on the taxpayer's eligibility for the federal credit. In general, the uniform definition should not affect head of household filing status.

- *Extension of the above-the-line deduction for educators*. Under previous law, an eligible educator was allowed an above-the-line deduction of up to $250 for amounts paid by

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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."

the teacher for books or supplies used in the classroom. This provision was set to expire with the 2003 taxable year. The WFTRA extended this provision for the 2004 and 2005 taxable years.

- *Extension of elective expensing of qualified environmental remediation expenditures*. Under previous law, a taxpayer could elect to treat qualified environmental remediation expenditures that would normally be charged to a capital account and depreciated over time as deductible in the current year. To be deductible currently, the expenditure must be paid or incurred with the abatement or control of hazardous substances at a qualified contaminated site. This provision would have expired with the 2003 tax year. The WFTRA extended this provision for the 2004 and 2005 taxable years.

- *Extension of enhanced deduction for qualified computer contributions*. Under previous law, corporations were allowed an enhanced charitable contribution deduction for contributions of computer technology or equipment to schools or public libraries that would use the computer equipment for educational purposes. This provision would have expired with the 2003 tax year. The WFTRA extended this provision for the 2004 and 2005 taxable years.

- *Elimination of the phase down of the deduction for qualified clean fuel property*. Under previous law, a taxpayer was allowed a specified deduction for clean fuel vehicles or refueling property placed into service before January 1, 2007. The amount of that deduction was to be reduced by 25% in 2004, 50% in 2005, and 75% in 2006, and was to be completely phased out in 2007. The WFTRA eliminated the phase down in the 2004 and 2005 taxable years. Without further action, the phase down will resume at 75% in 2006.

- *Extension of Archer Medical Savings Accounts (MSAs)*. Archer MSAs were designed to give small employers, their employees, and self-employed individuals a way of creating tax-deferred savings to offset qualifying medical expenses. The program was designed to be limited in scope: no new Archer MSAs could be set up after a certain threshold had been met or after the end of 2003. The WFTRA extends the period in which new Archer MSAs may be created until the end of 2005.

American Jobs Creation Act (AJCA) of 2004 (P.L. 108-357)

The American Jobs Creation Act of 2004 was signed into law by President Bush on October 22, 2004. The bill makes many substantial changes in many different areas of tax law. The act conforms to all but the following three federal tax law changes:

- It does not create a tonnage tax in lieu of an income tax on qualifying shipping activities.

- It does not create a deduction for income attributable to domestic production activities.

- It does not allow a deduction of state and local sales taxes in lieu of a deduction for state income taxes for the 2004 taxable year. The act conforms to this change for the 2005 taxable year, but requires an add back of the amount of sales taxes deducted.

The act does conform to the following changes for State tax purposes listed below:

- *Repeal of the exclusion for extraterritorial income (ETI)*. Under previous law, U.S. exporters were eligible for an exclusion from gross income for qualifying extraterritorial income. In 2000, the World Trade Organization declared this exclusion an illegal trade subsidy. Congress did not take action regarding this finding until the European Union

(EU) began placing sanctions on U.S. exports. At the time Congress acted, those sanctions were at 12% and were rising by one percentage point per month. This exclusion will be phased out over several years. The ETI exclusion will be reduced by 20% in 2005 and by 40% in 2006. The ETI exclusion will be eliminated altogether beginning in 2007. Based on Congress's enactment of this law, the EU has indicated it will drop sanctions on U.S. imports beginning January 1, 2005.

In part to replace the ETI exclusion, Congress created a new deduction for domestic production activities.[46] "Domestic production activities" is defined fairly broadly and includes the following:

- sale, lease, or license of property manufactured or produced by the taxpayer in significant part in the United States,
- sale, lease, or license of United States produced motion pictures and video tapes,
- sale of electricity, natural gas, or potable water within the United States,
- construction activities performed in the United States, and
- engineering or architectural services performed in the United States for construction projects occurring in the United States.

For taxable years beginning in 2009, the amount of the deduction is equal to nine percent (9%) of the lesser of the domestic production activities income of the taxpayer or taxable income without regard to the deduction. This deduction will be phased in over several years beginning in 2005. For the 2005 and 2006 taxable years the deduction will be limited to three percent (3%). This amount will grow to six percent (6%) for the 2007 and 2008 taxable years.

- *Extension of 179 expensing limit increase/revisions regarding SUVs*. Section 179 of the Code allows a taxpayer to treat the cost of certain property as an expense which is not chargeable to a capital account. This allows the taxpayer to take a deduction for the property in the year in which it is placed into service rather than depreciating the property over a number of years. In 2003, Congress increased the amount that could be expensed under Section 179 of the Code from $25,000 to $100,000.[47] The federal change was originally set to expire after the 2005 taxable year. The AJCA extends this provision through the 2007 taxable year.

  One frequent complaint about the federal provision was that it allowed expensing of costs associated with the purchase of a sports utility vehicle (SUV) by a small business. General rules relating to the depreciation of motor vehicles did not apply to many large SUVs because those rules applied only to vehicles weighing 6,000 pounds or less. The effect of this provision was to allow an immediate write-off for the purchase price of a large SUV, but to require more gradual depreciation for the purchase of most other passenger vehicles. Taxpayers thus had a greater incentive to purchase a large SUV. The AJCA limits the amount of the purchase price that may be expensed under Section

[46] As previously noted, the act does not create a deduction for income attributable to domestic production activities.

[47] The General Assembly conformed to this federal change as part of the 2003 Budget Act (S.L. 2003-284).

179 with respect to a vehicle weighing less than 14,000 pounds to $25,000[48] The federal legislation made this change effective when it became law, October 22, 2004.

- *Establishment of 15-year straight line cost recovery for qualified leasehold improvements and qualified restaurant property.*. The AJCA provides 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.

  If the leasehold improvement or restaurant property contains tangible personal property that may be segregated from the cost of other improvements and that tangible personal property has a shorter depreciation period, then the taxpayer may depreciate that property separately using the shorter period.

- *Modification of deduction for charitable contribution of used motor vehicles*. The AJCA limits the amount of the deduction for contributions of motor vehicles to charity. Vehicle donation programs have become popular in recent years. Generally, the taxpayer who has donated the motor vehicle has claimed a deduction for the full "blue book" value of the vehicle. The new law will limit the amount of the deduction based on how the donee organization uses the vehicle. If the charitable organization sells the vehicle without using it in any significant way, the amount of the deduction cannot exceed the gross proceeds of the sale. If the charity retains the vehicle for its own use, the taxpayer must receive an acknowledgment from the charity as to the value of the vehicle. The deduction may not exceed the acknowledged value of the vehicle to the charity. These changes become effective with the 2005 taxable year.

- *Establishment of an above-the-line deduction for certain attorney fees and court costs*. The AJCA allows an individual taxpayer an above-the-line deduction (i.e. from gross income) for attorney fees and court costs associated with certain civil rights actions, claims against the government, and Medicare fraud claims. Under previous law, these costs were deductible only as an itemized deduction, meaning that they were deductible only if the taxpayer itemized deductions and only to the extent aggregate itemized deductions exceeded 2% of the taxpayer's adjusted gross income. This provision became effective when the legislation became law, October 22, 2004.

- *Modification of deduction for automobile expenses of United States Postal Service employees*. The AJCA allows United States Postal Service employees who deliver and

[48] There are some exceptions to this rule for certain vehicles. These exceptions were put in place to ensure that the legislation would apply only to SUVs and not other types of heavy motor vehicles (such as delivery trucks) that have a weight greater than 6,000 pounds but less than 14,000 pounds.

collect mail on rural routes and receive qualified reimbursements of automobile expenses involving these duties to deduct their actual automobile expenses that exceed the reimbursement amount. This is an itemized deduction and therefore may be claimed only to the extent aggregate deductions exceed 2% of the taxpayer's adjusted gross income. Under previous law, the deduction could not exceed the amount of the qualified reimbursements, regardless of actual expenditures. As under previous law, reimbursements in excess of the amount of actual expenditures do not have to be included in gross income.

- *Exclusion of National Health Service Corps Loan Program repayments from gross income and from employment taxes*. The National Health Service Corps is an agency housed within the U.S. Department of Health and Human Services and has as its mission improving the health of the nation's underserved populations. Under the National Health Service Corps Loan Repayment Program, participants in the program may receive up to $25,000 per year for two years to pay off qualified educational loans. The loan repayment is in addition to any salary the participant receives from the employing community site. Under previous law, the amount of loan repayment was included in taxable income and was also subject to employment taxes (i.e. FICA). Under the AJCA, these loan repayments are to be excluded from both gross income and from employment taxes. This provision became effective with the 2004 taxable year.

- *Creation of a deduction for start-up costs and amendments to the expensing schedule for such costs*. Under the AJCA, a taxpayer may take a deduction of up to $5,000 for start-up and organization expenses of the taxpayer's trade or business. However, the amount of the deduction is reduced by the amount by which those expenses exceed $50,000. Any expenses in excess of $5,000 must be amortized over a 15-year period. Under previous law, no current expensing was allowed, the full amount of the start-up and organizational expenses would be amortized over 5 years. This provision is effective for expenses that occur on or after the date the legislation became effective, October 22, 2004.

- *Modification regarding the treatment of gain on the sale of a principal residence when the residence was acquired in a like-kind exchange*. Under current law, a taxpayer is allowed to exclude up to $250,000 of gain from the sale of a residence ($500,000 if a married couple filing jointly) if the taxpayer owned and used the residence as a principal residence for at least two of the last five years. The AJCA makes a change to this provision when the home was acquired as part of a like-kind exchange.[49] Under the AJCA, a residence received in a like-kind exchange must be owned by the taxpayer for at least five years and must be used as a principal residence of the taxpayer for at least two of the last five years in order to qualify for the exclusion from gross income of the gain on the sale of the residence. This provision became effective for residences sold on or after the date the legislation was enacted, October 22, 2004.

As previously noted, the act does not conform to three aspects of the federal tax law changes in the AJCA:

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49 A like-kind exchange is an exchange of property held for productive use in a trade or business or for investment for similar property. Unless cash is received as part of the trade, the exchange is not a taxable event.

- It does not create a tonnage tax in lieu of an income tax on qualifying shipping activities. – The AJCA provides that a corporation can elect to be subject to a tonnage tax rather than an income tax on its qualified shipping activities. The tonnage tax is based on the taxpayer's "notional shipping income." Notional shipping income is determined by reference to a monetary rate per ton shipped. The rate is 40 cents per 100 tons per day for the first 25,000 tons shipped per vessel and 20 cents per 100 tons per day for the amount shipped in excess of 25,000 tons per vessel. Once notional shipping income has been determined, tax is computed on that amount at the rate of 35%. In exchange for electing to be subject to the tonnage tax, the taxpayer may exclude from its gross income any amount resulting from its qualifying shipping activities. Conforming to this exclusion would result in income from shipping activities being excluded from taxation in North Carolina. In effect, it would result in a loss of tax revenues at the State level without a corresponding loss at the federal level. In order to maintain this revenue source, this act requires the taxpayer to add back the amounts deducted from gross income because of this new provision.

- It does not create a deduction for income attributable to domestic production activities. The AJCA phases out the exclusion for extraterritorial income: 20% in 2005, 40% in 2006; eliminated in 2007. Congress created a new deduction for domestic production activities to replace the ETI. "Domestic production activities" is defined fairly broadly. For taxable years beginning in 2009, the amount of the deduction is equal to 9% of the lesser of the domestic production activities income of the taxpayer or taxable income without regard to the deduction. This deduction will be phased in over several years beginning in 2005. For the 2005 and 2006 taxable years the deduction will be limited to 3%: this amount will grow to 6% for the 2007 and 2008 taxable years. In order to maintain this revenue source, this act requires the taxpayer to add back the amounts deducted from gross income because of this new provision.

- It does not allow a deduction of state and local sales taxes in lieu of a deduction for state income taxes for the 2004 taxable year. The act does conform to this change for the 2005 taxable year, but requires an add back of the amount of sales taxes deducted. The AJCA allows taxpayers to deduct state and local sales taxes in lieu of deducting state and local income taxes. This provision became effective with the 2004 taxable year and is set to expire for taxes beginning in 2006 and thereafter. Taxpayers that elect to deduct state and local sales taxes instead of state and local income taxes will have two options for determining the deductible amount: a) they may accumulate receipts for the actual amount of sales and use tax paid, or b) they may refer to tables prepared by the Secretary of the Treasury which estimate the amount of taxes paid based on average consumption and other factors.

  This federal provision is of particular benefit to taxpayers who reside in states that do not impose a personal income tax. For most North Carolina taxpayers, the greater benefit would come from deducting state income taxes rather than from deducting state and local sales taxes. Some exceptions to this general statement would include the following:

  - Nonresidents or part-year residents who reside in a state that does not impose an income tax and who have relatively low income tax liability in North Carolina or other states.

- Taxpayers who may have a low tax liability due to eligibility for a significant amount of tax credits.
- North Carolina residents for whom a large portion of income is not subject to taxation. This class of taxpayers would include many government retirees whose government pensions are not subject to State income tax under the decisions in *Bailey* and the related cases and whose Social Security payments are not subject to State income tax under G.S. 105-134.6.

North Carolina law currently requires taxpayers to add back the amount of the deduction allowed under the Code for state, local, and foreign income taxes. In order to treat the deduction for state and local sales taxes equivalent to the deduction for state, local, and foreign income taxes, the General Assembly would have to have required the add back of the deduction for state and local sales taxes if it had decided to conform to the federal change. This conformance would have been problematic, however, given that the federal legislation is effective for the 2004 taxable year and the General Assembly could not conform to the federal legislation and require the add back unless it acted before the end of the year. Although the practical effect of conforming to the change and requiring the add back is the same as not conforming to the change at all, a court could find that requiring an add back would in effect be a retroactive tax increase. Therefore, the act does not conform to the change allowing a deduction of state and local sales taxes in the 2004 taxable year, but does conform to that change and require an add back for the 2005 taxable year.

An Act to accelerate the income tax benefits for charitable cash contributions for the relief of victims of the Indian Ocean tsunami (P.L. 109-1).

On December 26, 2004, a large earthquake centered in the Indian Ocean unleashed a catastrophic tsunami that resulted in widespread devastation in 11 countries in South Asia, Southeast Asia, and Africa. The disaster is estimated to have caused billions of dollars in damages and produced a death toll in excess of 270,000.

On January 6, 2005, the first act of the 109th Congress was to approve accelerated tax benefits for charitable cash contributions for the relief of victims of the Indian Ocean tsunami. President Bush signed the act into law the following day. The act allows a taxpayer to treat a cash contribution for tsunami relief efforts made in January 2005, as if it were made on December 31, 2004. Thus, the taxpayer would be able to take a deduction in the 2004 taxable year rather than the 2005 taxable year. In order to qualify for the accelerated benefit, the contribution must be cash. Donations of property or cash substitutes, such as marketable securities, are not eligible for the accelerated benefits. In addition, the contribution must be specifically designated to be for tsunami relief. A contribution that is made to a charitable organization that is assisting in relief efforts but that is not specifically designated to relief efforts is not eligible for the accelerated benefits. For example, a donation to the Red Cross would be eligible for the accelerated benefit only if the donation were specifically designated for tsunami relief efforts; a general donation to the Red Cross would not be eligible for the accelerated benefit.

Part 36: Individual Income Tax Changes

Part 36 of the act extends the 8.25% upper-income individual income tax rate for tax years 2006 and 2007. The Governor's budget recommended a phase down of the upper income tax rate to 8% in 2006, and the elimination of the bracket in 2007.

In 2001, the General Assembly added a new tax bracket that imposed an additional one-half percent income tax (a total rate of 8.25%) on certain North Carolina taxable income for three years. The change was estimated to affect approximately 2% of North Carolina taxpayers. In 2003, the General Assembly extended the tax rate for two more years. This act retains the upper bracket for two additional years.

Under prior North Carolina law, tax was imposed at the following rates on individuals' North Carolina taxable income:

Tax Rate	Married filing jointly	Heads of household	Single filers	Married filing separately
6.0%	Up to $21,250	Up to $17,000	Up to $12,750	Up to $10,625
7.0%	Over $21,250 and up to $100,000	Over $17,000 and up to $80,000	Over $12,750 and up to $60,000	Over $10,625 and up to $50,000
7.75%	Over $100,000	Over $80,000	Over $60,000	Over $50,000

The 2001 law created a fourth tax bracket for North Carolina taxable income as follows:

Tax Rate	Married filing jointly	Heads of household	Single filers	Married filing separately
8.25%	Over $200,000	Over $160,000	Over $120,000	Over $100,000

This part of the act was later amended in section 46 of S.L. 2005-345 (Modify 2005 Appropriations Act) to increase from $1 to $3 the amount that an individual income taxpayer may designate on the taxpayer's return to be allocated to the North Carolina Political Parties Financing Fund. The amount is for use by the political party designated by the taxpayer.

Part 38: Corporate, Excise, and Insurance Tax Changes[50]

This part equalizes the gross premiums tax on insurance companies by taxing health maintenance organizations (HMOs) at the same rate as other insurers. HMOs are currently taxed at 1%. This part repeals the special 1% rate for HMOs and taxes HMOs at 1.9%, effective for taxable years beginning on or after January 1, 2007. Prior to 2001, HMOs did not pay a gross premiums tax.[51]

In 2001, the General Assembly enacted legislation subjecting all insurance carriers to the gross premiums tax in lieu of the State's corporate income and franchise tax. However, the rate continued to vary depending upon the type of insurer. The 2001 legislation taxed HMOs and Article 65 corporations, such as Blue Cross/Blue Shield and Delta Dental Corporation, at the

[50] The Senate version of Senate Bill 622 would have reduced the corporate income tax rate from 6.9% to 6.4% and repealed the earmarking of a percentage of the corporate income tax collections to the Public School Building Capital Fund. The House version would have equalized the privilege tax on entertainment by taxing all forms of entertainment at a rate equal to the combined State and local sales tax rate, and would have provided an income tax credit to a small business that provides health insurance to its full-time employees.

[51] Prior to 2001, HMOs were subject to corporate income and franchise taxes. Companies that pay a gross premiums tax are exempt from State corporate income and franchise taxes.

rate of 1%. Effective January 1, 2004, the General Assembly increased the gross premiums tax on Article 65 corporations from 1% to 1.9%. This act increases the rate on HMOs to 1.9%, effective for taxable years beginning January 1, 2007. For the 2007 tax year only, HMOs are directed to make the following estimated payments of the tax: 50% on April 15 and 50% on June 15, with true-up the following March 15. For subsequent tax years, the general law on installment payments of gross premiums tax applies. This change accelerates the timing of the tax payment to move the revenue gain to an earlier fiscal year.

Part 39: Tax Incentives/Film Industry Jobs Incentives

This part replaces the current film industry development grant program[52] with a refundable income tax credit equal to 15% of the qualifying expenses spent by a production company in connection with a production. However, the amount of the credit with respect to a feature film production is capped at $7.5 million. The credit is effective for taxable years beginning on or after January 1, 2005, and applies to qualifying expenses occurring on or after July 1, 2005. The credit expires for qualifying expenses occurring on or after January 1, 2010. The incentive is targeted at feature films, episodic television series, and commercial advertising. The Governor's budget exempted from sales and use tax, sales to a production company of film or video production equipment.

Under G.S. 105-164.3, a production company is defined as a person engaged in the business of making original motion picture, television, or radio images for theatrical, commercial, advertising, or educational purposes. However, for the purposes of the new credit, the production may not be any of the following: political advertising, television production of a news program or live [53] sporting event, a radio production, or a production containing obscene material.[54] In the case of an episodic television series, an entire season of episodes is considered one production.

In order to obtain the credit, the taxpayer must have qualifying expenses in excess of $250,000 with respect to a production and provide on its return a detailed accounting of qualifying expenses. Qualifying expenses are the total amount spent in North Carolina for the following:

- Goods and services purchased by a production company in connection with a production. For goods with a purchase price of $25,000 or more, the amount included in qualifying expenses is the purchase price less the fair market value of the goods at the time the production is completed.
- Compensation and wages paid by a production company on which it remitted withholding payments to the Department of Revenue. Any amounts paid to an individual

[52] Section 39.1(d) of this part repeals G.S. 143B-434.4, which creates the Film Industry Development Account. The General Assembly has not appropriated money to this account for the past couple of years.

[53] Section 47 of S.L. 2005-345 amended this part to clarify that the sporting event ineligible for the credit is a "live" sporting event and to define the term "live sporting event".

[54] G.S. 14-190.1 defines "obscene" material as material that meets all of the following conditions: the material depicts or describes in a patently offensive way sexual conduct; the average person applying contemporary community standards relating to the depiction or description of sexual matters would find that the material taken as a whole appeals to the prurient interest in sex; the material lacks serious literary, artistic, political, or scientific value; and the material as used is not protected or privileged under the Constitution of the United State or the Constitution of North Carolina.

who receives in excess of $1 million with respect to a single production cannot be included in a qualifying expense.

The taxpayer must maintain and make available for inspection any information or records required by the Secretary of Revenue or the regional film commissions. The taxpayer has the burden of proving eligibility for the credit and the amount of the credit. The Secretary of Revenue may consult with the North Carolina Film Office of the Department of Commerce and the regional film commissions in order to determine the amount of qualifying expenses.

The credit may be claimed for the taxable year in which the production activities are completed. The credit is computed based on all of the taxpayer's qualifying expenses incurred with respect to the production, not just the qualifying expenses incurred during the taxable year. If the credit exceeds the amount of tax imposed for the taxable year reduced by the sum of all credits allowable, the Secretary must refund the excess to the taxpayer. A pass-through entity is considered a taxpayer for purposes of claiming this credit; therefore, it does not distribute the credit among its owners. The taxpayer may not claim the credit for qualifying expenses for which it claimed a deduction under the Internal Revenue Code.

The Department of Revenue must publish by May 1 of each year the following information, itemized by taxpayer for the 12-month period ending the preceding December 31:

- The location of the sites used in a production for which a credit was claimed.
- The qualifying expenses for which a credit was claimed, classified by whether the expenses were for goods, services, or compensation.
- The number of people employed in the State with respect to the credits claimed.
- The total cost to the General Fund of the credits claimed.

Finally, this part amends the tax secrecy statutes to allow the exchange of information concerning the credit with the North Carolina Film Office of the Department of Commerce and the regional film commissions.

PRESENT-USE VALUE BUYOUT CREDITS.

Session Law	*Bill #*	*Sponsor*
S.L. 2005-293	**HB 705**	**Representative Hill**

AN ACT TO ALLOW BUYOUT PAYMENTS TO COUNT TOWARDS THE ONE THOUSAND DOLLAR GROSS INCOME REQUIREMENT FOR AGRICULTURAL LAND FOR PRESENT-USE VALUE TAX EXEMPTIONS.

OVERVIEW: This act allows payments received under the tobacco quota buyout program to be counted towards the $1,000 income requirement which must be met before agricultural land can be assessed at present-use value for property tax purposes.

FISCAL IMPACT: The Department of Revenue does not expect that this act will result in any significant amount of additional acreage being assessed at present-use value.
(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2005 Session. Available in the Legislative Library.)

EFFECTIVE DATE: This act is effective for taxes imposed for taxable years beginning on or after July 1, 2005.

ANALYSIS: Agricultural land, horticultural land and forestland have been designated as a special class of property and are appraised and assessed at present-use value, instead of market value, for property tax purposes if the land meets certain statutory requirements. Agricultural land must be part of a farm unit, under a sound management program, individually owned, consist of one or more tracts (one of which must consist of at least 10 acres that are in actual production) and for the three years preceding January 1 of the year for which the present-use value benefit is claimed, have produced an average gross income of at least $1,000. Counted income includes the following:

- Income from the sale of agricultural products produced from the land, and
- Payments received under a governmental soil conservation or land retirement program

This act allows payments received under the Fair and Equitable Tobacco Reform Act of 2004 to be included as income when determining the present-use value eligibility of agricultural land. The agricultural land must continue to meet the ownership and actual production requirements.

Congress passed the Fair and Equitable Tobacco Reform Act of 2004 in October, 2004. That act repeals the federal tobacco price support and quota programs, provides compensation payments to tobacco quota owners and growers, and provides an assessment mechanism for tobacco manufacturers and importers to pay for the buyout. An eligible quota owner is the owner of a farm on the date the federal legislation was enacted, October 22, 2004, for which a basic tobacco quota/allotment was established for the 2004 marketing year. An eligible quota grower is an owner, operator, landlord, tenant or sharecropper who shared in the risk of producing tobacco in the 2002, 2003, or 2004 marketing year. Quota owners will be paid $7 per pound for the basic quota they owned in 2002. Growers will be paid $3 per pound for their 2002 effective quota.[55] These payments will be distributed equally over 10 years, beginning with the 2005 fiscal year and ending in 2014. The initial payment was made by the beginning of October 2005. The buyout is funded by quarterly assessments on tobacco manufacturers and importers. Because the buyout is funded by manufacturer and importer assessments, future Phase II payments will be terminated. For federal tax purposes, quota owner payments are treated as capital gains and grower payments are expected to be treated as ordinary income. As of October 2005, the I. R. S. had not ruled on the tax status of these payments.

PROPERTY TAX PAID WITH VEHICLE REGISTRATION.

Session Law	*Bill #*	*Sponsor*
S.L. 2005-294	**HB 1779**	**Rep. Folwell, Insko, Justice, Walker**

AN ACT TO CREATE A COMBINED MOTOR VEHICLE REGISTRATION RENEWAL AND PROPERTY TAX COLLECTION SYSTEM.

OVERVIEW: This act creates a combined system for motor vehicle registration renewal and property tax collection. Currently, the two systems, though interrelated, are run separately and administered by different entities.

[55] The payment is $2 per pound if the grower participated in two of the three marketing years, and $1 per pound if the grower participated in only one of the three marketing years.

FISCAL IMPACT: The NC Association of Tax Assessors estimates that this act will result in collection of approximately $72 million annually in additional motor vehicle property taxes that currently go uncollected. Counties will also likely experience savings from the elimination of resources devoted to collection of property taxes on motor vehicles, including staff time and mailings for delinquent notices. An administrative fee equal to the cost of preparing and mailing notices will be retained by the Department of Revenue. A second fee for the cost of collection of taxes and fees will be retained by the Division of Motor Vehicles and tag agents. The bill will require significant changes in DMV operations and significant costs for changing DMV computer systems. The full extent of these changes and costs is not currently known.
(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2005 Session. Available in the Legislative Library.)

EFFECTIVE DATE: Different portions of the act have different effective dates as specified in the analysis. Most of the act becomes effective on the earlier of January 1, 2009, or the date when the Department of Revenue and the Division of Motor Vehicles have certified that an integrated computer system is in operation. The act became law when signed by the Governor on August 22, 2005.

ANALYSIS: Since 1993, all motor vehicles, except public service company vehicles appraised by the Department of Revenue and manufactured homes, are classified for listing, assessment, and taxation separately from other classes of property. The classified motor vehicles consist of two groups; those that are registered with the Department of Transportation's Division of Motor Vehicles (DMV) and those that are not registered with the DMV.[56]

The county in which the motor vehicle is registered assesses the vehicle for property taxes on a revolving, year-round basis. To accomplish this, DMV gives each county a monthly list of all the motor vehicles in the county for which the registration was renewed or obtained two months earlier. The county then lists and appraises each vehicle and sends the owner of the vehicle a bill for the county, municipal, and special district property taxes due. The result is that a motor vehicle owner receives a tax bill for the vehicle approximately three months after the vehicle is registered or the registration is renewed. Each month, the county tax collector collects taxes on approximately one-twelfth of the motor vehicles having a tax situs in the county. If the taxes on the registered motor vehicle are not paid within one month after they become due, then the motor vehicle owner is liable for interest at the rate of 2% a month for the first month following the date the taxes were due and ¾ % for each month thereafter. In addition, if the taxes are not paid, the county includes the motor vehicle on a list that is sent to the DMV. The DMV then refuses to renew the vehicle's registration the following year unless the taxpayer obtains a receipt showing that the previous year's taxes have been paid.[57] Unpaid taxes may also be collected by levying on the motor vehicle or other personal property of the owner, but the unpaid taxes do not become a lien on the owner's real property.

The DMV requires motor vehicles to be registered annually. Under G.S. 20-66, the registration of a vehicle that is renewed by means of a registration renewal sticker expires at midnight on the last day of the month designated on the sticker. It is lawful, however, to operate the vehicle on a highway until midnight on the fifteenth day of the month following the month in which the sticker expired. The DMV varies the expiration dates of registration renewal stickers for a type of vehicle so that an approximately equal number expires at the end of each month, quarter,

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[56] A vehicle is not registered with the DMV either because it is a tractor, an earthmover, or some other type of vehicle that cannot be registered with the DMV or it is a car or truck and could be, but for some reason is not, registered with the DMV.
[57] Vehicle owners may get around this block by buying a new tag on the vehicle.

or other period consisting of one or more months. The $28 fee[58] is paid to the DMV and credited to the Highway Fund.

This act combines the motor vehicle registration and property tax billing and collection into a combined process. The goals of the combined process are to reduce the number of taxpayer interactions with government, save money, increase the overall efficiency of both functions, and improve the property tax collection rate on motor vehicles.

Beginning January 1, 2006, the interest rate on unpaid taxes on classified motor vehicles will increase from 2% for the first month to 5% for the first month following the date the taxes were due. Instead of going to the taxing unit that is the situs of the motor vehicle, 60% of the interest collected on unpaid taxes on registered vehicles will be transferred on a monthly basis to a special account created within the Treasurer's Office. The North Carolina Association of County Commissioners will direct the Treasurer to distribute funds from the account for the purpose of developing and implementing an integrated computer system within the DMV. The system will allow for the combined assessment, billing, and collection of property taxes on motor vehicles and the issuance of registration plates.

Beginning 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, the following changes will occur:

- Property tax on registered motor vehicles will be due on the date that 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).
- The Property Tax Division of the Department of Revenue shall prepare and mail a combined tax and registration notice for each registered vehicle. The notice will contain the date of the notice, the appraised value of the vehicle, the tax rate of the taxing units, a statement that the appraised value of the motor vehicle may be appealed to the assessor before the taxes and fees become delinquent, and the registration fee imposed by the DMV.
- The Department of Revenue may receive a fee for each combined notice generated for a registered vehicle. The fee must be equal to the actual cost of printing and sending the combined notice and will be subtracted from the taxes and fees remitted to the county or municipal corporation in which the vehicle is registered.
- The property taxes and registration fees must be paid either to the DMV or an agent contracting with the DMV. The taxes and fees do NOT have to be paid in the county that is the situs of the vehicle.
- The DMV or its agent may retain a fee for collecting the county and municipal taxes and fees. This fee must be an amount equal to at least 1/3 of the compensation paid for registration renewals conducted by contract agents under Chapter 20 of the General Statutes. This fee is in addition to the $1.43 that is currently paid to contract agents for each registration renewal.
- The DMV or its agent must provide a weekly financial report containing information required by the Property Tax Division to the taxing units and the DMV to enable them to account for payments received.

[58] This fee was raised from $20 to $28 in the 2005 Appropriations Act, S.L. 2005-276.

- G.S. 105-330.7 is repealed. It will no longer be necessary for the tax collector to send a monthly list to the DMV of classified vehicles on which taxes remain unpaid, because the taxes and registration fees will be paid to the same entity at the same time.
- Interest at the rate of 5% for the remainder of the month following the month in which the registration renewal sticker expired will also accrue on unpaid registration fees on classified motor vehicles. Interest collected on unpaid registration fees will be transferred on a monthly basis to the North Carolina Highway Fund for technology improvements within the DMV. The interest collected on unpaid property taxes will no longer go into the special account in the Treasurer's office but will remain with the taxing units.
- G.S. 20-50.3 is repealed. Once the computer system is in operation, the DMV will no longer need to furnish county tax assessors a list of registered vehicles.

Effective when the act became law, August 22, 2005, the Property Tax Division within the Department of Revenue and the DMV shall jointly study and develop a plan for determining the method of valuation of 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 following organizations: 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 Treasurer must report to the Revenue Laws Study Committee semi-annually, with the first report due by April 30, 2006. The report must contain a detailed description of the moneys transferred and distributed from the special account.

The Property Tax Division within the Department of Revenue and the DMV must report findings and recommendations of its joint study to the Revenue Laws Study Committee, the Joint Legislative Transportation Oversight Committee, and the Fiscal Research Division by April 30, 2006.

PROPERTY TAX % VALUE OF MOTOR VEHICLES.

Session Law	*Bill #*	*Sponsor*
S.L. 2005-303	**HB 988**	**Rep. Blackwood, Church**

AN ACT TO EXCLUDE HIGHWAY USE TAXES AS A FACTOR IN DETERMINING THE TRUE VALUE IN MONEY OF MOTOR VEHICLES FOR PROPERTY TAX PURPOSES.

OVERVIEW: This act provides that when a tax assessor considers the sales price of a motor vehicle in determining the true value of the vehicle for property tax purposes, the assessor may not consider the highway use tax as part of the sales price.

FISCAL IMPACT: According to the North Carolina Department of Revenue, there are no counties currently using the sales price to determine the value of motor vehicles. Most counties use pricing guides developed by Tax Equity Consultants (TEC) or the National Automobile Dealers Association to determine the average retail prices paid for motor vehicles. In some instances in which the assessed value of a vehicle is appealed by the taxpayer, assessors may use the bill of sale that includes highway use tax as documentation for changing the assessed

value. To the extent that this occurs, this act will result in lower revenue for local governments. It is expected that the revenue impact would be small; however, the exact amount is not known. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2005 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act is effective for taxes imposed for taxable years beginning on or after July 1, 2005. The act became law when signed by the Governor on August 22, 2005.

ANALYSIS: By statute, a county must appraise motor vehicles at their true value in money for property tax purposes. True value is defined as the price at which property would change hands between a willing and financially able buyer and a willing seller. In practice, assessors use a pricing guide developed by TEC Data Systems to determine the value of vehicles for property tax purposes. The pricing guide reflects the average retail price paid for motor vehicles. In determining retail prices, all costs that are necessary to acquire and operate a motor vehicle are considered. If an assessor believes the values developed in the guide are too low or too high, the assessor may consult with TEC Data Systems about the values and have a different set of values computed for use in that assessor's county. If a taxpayer disagrees with the appraised value, the taxpayer has 30 days after the date the tax notice was prepared to appeal the value. Counties will adjust an appraised value for reasons such as the vehicle's condition or excessive mileage.

Counties typically do not begin their appraisal of a new motor vehicle based on the vehicle's bill of sale. However, there are instances where a taxpayer may bring in a bill of sale to show that he or she paid less than the value at which the vehicle is assessed. A vehicle's bill of sale includes the 3% highway use tax paid on the vehicle. This act provides that when an assessor considers the sales price of a motor vehicle in determining its true value, the assessor must not consider the highway use tax paid on the vehicle.

PROPERTY TAX CHANGES.

Session Law	*Bill #*	*Sponsor*
S.L. 2005-313	**HB 116**	**Representative Brubaker**

AN ACT TO CLARIFY PRESENT-USE VALUE ELIGIBILITY, TO AMEND THE PERIOD FOR APPEAL OF A PRESENT-USE VALUE DETERMINATION OR APPRAISAL, TO MODIFY THE TAX YEAR FOR MOTOR VEHICLES THAT ARE TO BE SWITCHED FROM AN ANNUAL SYSTEM OF REGISTRATION TO A STAGGERED SYSTEM EFFECTIVE JANUARY 1, 2006, AND TO APPLY THE SAME PENALTY THAT CURRENTLY APPLIES TO PAYMENTS BY CHECK TO PROPERTY TAX PAYMENTS MADE BY ELECTRONIC PAYMENTS.

OVERVIEW: This act makes clarifying and technical changes to the present-use value statutes, clarifies the tax year for motor vehicles that are to be switched from an annual system of registration to a staggered system, and imposes a penalty for nonpayment of property taxes on an electronic funds transfer that cannot be completed because of insufficient funds.

FISCAL IMPACT: This act would only impact local revenues and no fiscal impact is expected. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2005 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The changes made by the act to the motor vehicle property tax statutes become effective January 1, 2006. The other provisions are effective for taxes imposed for taxable

years beginning on or after July 1, 2005. The act itself became law when the Governor signed it into law on August 25, 2005.

ANALYSIS: This act makes changes in three different parts of the property tax statutes.

Present-Use Value. – Since 1973, the General Assembly has provided that farmland may be appraised, assessed, and taxed at its present-use value, as opposed to its fair market value. The present-use value classification helps preserve farmland by insulating it from the rising property tax values cause by competing market pressures to develop farmland for commercial and residential purposes. In 2002, the General Assembly provided an updated method for calculating the value of farmland in its present use. In 2004, the Department of Revenue indicated to the Property Tax Subcommittee of the Revenue Laws Study Committee that the present-use value statutes needed to be clarified to help the counties and the Department with their administration of the classification. Sections 1 through 7 of this act make those changes. These changes codify existing practices among county assessors.
The act provides that certain land defined as horticultural land may be treated as agricultural land when there is no significant difference in the cash rental rates for the land.[59] This provision applies to land used to grow horticultural and agricultural crops on a rotating basis and to land used to grow a horticultural crop that is set out or planted and harvested within one growing season.

Under the present-use value system, farmland must be part of a unit engaged in commercial production. A 'unit' is one or more tracts of farmland. Under this act, multiple units must be under the same ownership and be of the same type of classification. If the multiple tracts are located within different counties, then the tracts must be within 50 miles of a qualifying tract. Prior to this act, multiple tracts in different counties could be considered part of the same unit if they either shared the same classification or shared the same equipment or labor force. This act removes the latter condition and requires that multiple tracts in different counties must share the same classification to qualify as a unit.

For property to qualify for present-use value classification, it must meet certain ownership requirements in addition to use and income requirements. Generally speaking, a qualifying owner must own the property for four years or the property must be the home of the qualifying owner. Prior to 2002, there existed an exception to the ownership requirement that allowed an owner to immediately qualify newly acquired property for use value classification if the property was appraised at its present use value at the time title to the land passed to the new owner or the property *was eligible for appraisal* at its present use value so long as the new owner continued to use the property for farm purposes. In 2002, the General Assembly amended this exception to require the new owner to file a timely application for the newly acquired property and to agree to accept liability for the deferred taxes. The new condition of accepting liability for the deferred taxes conflicts with the old condition that the property *be eligible for* use value classification since there would be no deferred taxes to assume unless the property was currently appraised at its present-use value when the property was transferred. This act removes this ambiguity by setting forth two different exceptions to the ownership requirements:

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[59] Effective with the 2003 property tax year, the value of agricultural and horticultural land is determined by the estimated cash rental rates for the land. Prior to 2003, the value of agricultural land was determined by the income of corn and soybean yields and the value of horticultural land was determined by horticultural product yields.

- It removes the phrase 'or was eligible for appraisal at its present use value' from the first exception.
- It creates a new exception for property for which there are no deferred taxes. It will allow property *eligible for* use value classification to immediately qualify in the hands of a new owner if the new owner has other property classified at present use and files a timely application for use-value classification.

Lastly, the act establishes 60 days as the time within which a taxpayer (1) must appeal an assessor's decision regarding the qualification or appraisal of the taxpayer's property as use value property and (2) may submit additional information to reverse a disqualification of property for present-use value classification or for exemption or exclusion because of failure to submit additional information. Current law provides no time limit for presenting additional information after the assessor has disqualified the property. The 60-day time limit corresponds to the current timeframe a new owner has to file an application for use value treatment after acquiring the property. [60]

Motor Vehicles. – Sections 8 and 9 of the act clarify how the motor vehicle property tax year will be accomplished for commercial vehicles that are converting from an annual registration system to a staggered registration system. Most vehicles registered with the Division of Motor Vehicles are taxed for property tax purposes on a revolving, year-round basis that corresponds with their vehicle registration and renewal. Commercial trucks are registered under the annual system. However, in 2004 the General Assembly enacted legislation that provides for the staggered issuance of commercial vehicle and dealer license plates, effective January 1, 2006. The Department of Revenue estimates this change will affect approximately 500,000 annually registered motor vehicles. To accomplish this transition, this act provides for a motor vehicle tax year greater than 12 months during the period that the vehicles are converting from annual registration to staggered registration. This change will allow the Division to issue one-time 7- to 18-month registrations for these vehicles, resulting in an approximate equal number of expiring registrations throughout a 12-month period. Upon renewal of these one-time registrations, the subsequent registrations will be 12-month registrations. The act specifies how the tax calculation is made for tax bills when the registration cycle is not 12 months.

Electronic Funds Transfer. – Section 10 of the act provides that the same penalty and penalty waiver provisions that apply to payments of property taxes by check also apply to payment of property taxes by electronic funds transfer. If a worthless check is given for payment of property taxes, the penalty is $25 or 10% of the amount of the check, whichever is greater, subject to a maximum of $1,000. The penalty does not apply if the tax collector finds that the taxpayer inadvertently failed to draw the check on the taxpayer's account that had sufficient funds.

ADD AGENCIES TO SET-OFF DEBT COLLECT.

Session Law	*Bill #*	*Sponsor*
S.L. 2005-326	**SB 682**	**Senator Holloman**

[60] G.S. 105-277.4(a). The General Assembly enacted the provision requiring a new owner to submit an application for use-value classification for newly acquired property within 60 days after its purchase in 2002.

AN ACT TO EXTEND TO PUBLIC HEALTH AUTHORITIES, SANITARY DISTRICTS, AND METROPOLITAN SEWERAGE DISTRICTS THE SET-OFF DEBT COLLECTION PROCEDURES CURRENTLY AVAILABLE TO COUNTIES AND CITIES.

OVERVIEW: This act adds public health authorities, metropolitan sewerage districts, and sanitary districts to the list of agencies authorized under the Setoff Debt Collection Act to collect debts owed to them by obtaining a setoff against a debtor's North Carolina income tax refund.

FISCAL IMPACT: No fiscal impact.

EFFECTIVE DATE: This act becomes effective January 1, 2006, and applies to income tax refunds determined on or after that date.

ANALYSIS: The Setoff Debt Collection Act authorizes State and local agencies to collect debts by diverting part or all of an individual's income tax refund to pay a debt the individual owes to a particular agency. Thus, the debt the individual owes the agency is set off against the individual's income tax refund. Before January 1, 2000, the setoff program was open only to State agencies. Since 2000, authorized local agencies[61] participate through a clearinghouse. Because there are so many local agencies, funneling their claims through a clearinghouse avoids an undue administrative burden on the Department of Revenue. A $15.00 collection assistance fee is added to each local agency debt submitted for setoff, which is remitted to the clearinghouse that submitted the debt. In addition, a $5.00 collection fee is added to each debt, State or local, that is submitted for setoff, which is retained by the Department of Revenue. The fees do not, however, apply to child support debts. While the use of debt setoff for State agencies is mandatory, usage by local agencies is optional. The Act only applies to debts that are at least $50 and to a refund that is at least this same amount.

This act allows public health authorities,[62] metropolitan sewerage districts,[63] and sanitary districts[64] to participate under the Setoff Debt Collection Act in the same manner as other

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[61] In 1997, the General Assembly extended the Setoff Debt collection act to counties and municipalities, effective in 2000. In 2003, the General Assembly added water and sewer authorities to the list of entities eligible to participate in debt setoff. In 2004, regional joint agencies created by interlocal agreement were added.

[62] Although a public health authority functions similarly to a county agency, it is a separate legal entity created under G.S. 130A-45.02. A public health authority is created by joint resolution of a county board of commissioners and the local board of health. It functions as a policy-making, rule-making, and adjudicatory body designed to protect and promote the public health. Among its powers, a public health authority may establish a fee schedule for services received from public health facilities. Currently, there is only one public health authority, created under this authorizing legislation, and it is the Hertford County Public Health Authority.

[63] Any two or more political subdivisions in one or more counties, or any political subdivision and any unincorporated area within one or more counties, may petition for the creation of a metropolitan sewerage district by filing a resolution with the boards of county commissioners of the county or counties within which the proposed district will lie. A public hearing is then held where the Environmental Commission and board of county commissioners determine whether the creation of the metropolitan sewerage district would preserve and promote the public health and welfare of the area. A sewerage district board has the authority to levy taxes on property within the district and impose charges for the services furnished. The district board may provide methods for collection of charges and measures for enforcement of collection, including penalties and the denial or discontinuance of service.

[64] The Commission for Health Services may create sanitary districts for the purpose of preserving and promoting the public health and welfare. A sanitary district is incorporated if 51% of the freeholders in the proposed district petition the county board of commissioners of the county in which all or the largest portion of the land of the proposed district is located. A sanitary district board has the authority to levy

authorized local agencies. Like other authorized local agencies, these agencies would be authorized to submit their debts for collection by setoff through a local clearinghouse only after providing the debtor with notice, an opportunity to be heard before the authority, and an appeal process pursuant to the Administrative Procedure Act.

FUEL TAX REFUND FOR PUMPERS AND SWEEPERS.

Session Law	*Bill #*	*Sponsor*
S.L. 2005-377	**SB 356**	**Senator Hoyle**

AN ACT TO ALLOW A FUEL TAX REFUND FOR OFF-ROAD FUEL USE BY PUMPER TRUCKS AND SWEEPERS.

OVERVIEW: This act adds the following two vehicles to the list of vehicles that are allowed an annual refund of the motor fuel taxes paid on fuel consumed by the vehicles:

- A commercial vehicle that uses a power takeoff to remove and dispose of septage and for which an annual fee is paid to the North Carolina Department of Environment and Natural Resources under the septage management program.
- A sweeper.

FISCAL IMPACT: The fiscal impact for allowing a fuel tax refund for off-road fuel used by pumper trucks is estimated to result in the following gains to the General Fund and Local Governments and the following losses to the Highway Fund and Highway Trust Fund. There is no estimate available for sweepers.

	FY 2005-06	FY 2006-07	FY 2007-08	FY 2008-09	FY 2009-10
GF	$124,461	$122,369	$118,142	$113,016	$111,109
HF	($458,067)	($460,701)	($461,680)	($461,084)	($464,837)
HTF	($152,689)	($153,567)	($153,893)	($153,695)	(154,946)
LG	$ 77,788	$ 76,481	$ 73,839	$ 70,635	$ 69,443

(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2005 Session. Available in the Legislative Library.)

EFFECTIVE DATE: This act became effective when it was signed into law by the Governor on September 8, 2005, and applies to motor fuel and alternative fuel consumed on or after January 1, 2006.

ANALYSIS: Certain vehicles that use motor fuel to conduct their work, as distinguished from propelling them on the highway, are allowed an annual refund of a portion of the motor fuel taxes paid. The amount of the refund is equal to 33 1/3% of the sum of the flat cents-per-gallon rate in effect during the year for which the refund is claimed and the average of the two variable cents-per-gallon rates in effect during the year. The amount of sales tax due on the fuel is deducted from the refund.

The act adds the following two types of vehicles to the list of vehicles that are eligible for this fuel tax refund:

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property taxes within the district and apply service charges and rates based on the benefits provided. Sanitary districts that maintain and operate a sewage system may bring suit for overdue sewer charges and disconnect the sewer lines. This remedy is not sufficient when the customer moves out of the district. The charges also become a lien on the property served and the property may be sold.

- A commercial vehicle that uses a power takeoff to remove and dispose of septage and for which an annual fee is required to be paid to the Department of Environment and Natural Resources (DENR) under its septage management program.[65] In order to issue the refund, the Department of Revenue is not required to verify the payment of the permit fee as required by G.S. 130A-291.1.[66] If the Department, however, discovers through its auditing or investigatory procedures that those permit fees have not been paid, it may refuse to issue a refund or seek a return of the refund.
- Sweeper. A sweeper is a vehicle that vacuums up and hauls away litter in parking lots. A sweeper vehicle has an auxiliary engine that runs only when the vehicle is performing its sweeping function. A factory-installed meter gauges how much fuel is being used for that function.

The other vehicles eligible for this refund include concrete mixing vehicles; solid waste compacting vehicles; bulk feed vehicles that deliver feed to poultry or livestock and use power takeoffs to unload the feed; vehicles that deliver lime or fertilizer in bulk to farms and use power takeoffs to unload the lime or fertilizer; tank wagons that deliver alternative fuel, motor fuel, or another type of liquid fuel into storage tanks and use power takeoffs to make the deliveries; and commercial vehicles that deliver and spread mulch, soils, compost, sand, sawdust, and similar materials and that use power takeoffs to unload, blow, and spread these materials.

GARVEE BOND ISSUANCE.

Session Law	*Bill #*	*Sponsor*
S.L. 2005-403	**HB 254**	**Representative Crawford**

AN ACT TO AUTHORIZE THE STATE TREASURER TO ISSUE "GARVEE" GRANT ANTICIPATION REVENUE VEHICLE BONDS ON BEHALF OF THE DEPARTMENT OF TRANSPORTATION, TO REQUIRE "GARVEE" FUNDS TO BE DISTRIBUTED IN ACCORDANCE WITH THE EQUITY DISTRIBUTION FORMULA, AND TO DIRECT THE SECRETARY OF THE DEPARTMENT OF TRANSPORTATION AND THE STATE TREASURER TO DEVELOP AN IMPLEMENTATION PLAN FOR ISSUANCE OF THE BONDS, AS RECOMMENDED BY THE JOINT LEGISLATIVE TRANSPORTATION OVERSIGHT COMMITTEE, AND TO CLARIFY THE DEFINITION OF GOVERNMENTAL UNIT FOR PURPOSES OF INTEREST RATE SWAP AGREEMENTS.

OVERVIEW: This act does two things:

- It authorizes the use of GARVEE bonds to finance projects in the Intrastate Highway System and the Transportation Improvement Program.
- It modifies the definition of 'governmental unit' for purposes of interest rate swap agreements to mirror the language in the statute authorizing swap agreements.

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[65] Under G.S. 130A-291.4, DENR is responsible for administering a septage management program which includes establishing standards for transportation, storage, treatment, and disposal of septage; operator registration and training; the issuance, suspension, and revocation of permits; and procedures for the payment of annual fees.

[66] An earlier version of Senate Bill 356 allowed a refund to a vehicle for which an annual fee is "paid" to DENR, while the ratified version allows a refund to a vehicle for which an annual fee is "required to be paid" to DENR.

FISCAL IMPACT: This act is not projected to impact State revenues since the debt service for the bonds will be paid by federal funds.
(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2005 Session. Available in the Legislative Library.)

EFFECTIVE DATE: The authority to issue GARVEE bonds becomes effective February 1, 2006. The remainder of the act became effective when the Governor signed it into law on September 20, 2005.

ANALYSIS: GARVEEs, Grant Anticipation Revenue Vehicles, represent one of the tools Congress provides to the states to facilitate the development and acceleration of highway projects. With GARVEEs, states may issue bonds secured by future federal highway funds. The debt itself is a state responsibility; a GARVEE does not carry with it any guarantee for repayment from the federal government. However, the federal aid highway program represents a long-standing source of transportation revenue and many investors appear willing to accept the risk that Congress will continue to authorize highway funds for the full term of the bonds.

This act authorizes the Department of Transportation to issue GARVEE bonds to finance federal-aid highway projects. A state may elect to pledge their obligations of future federal-aid funds as the only security backing the federal share of the obligation to investors (non-recourse GARVEES) or to pledge other sources of revenue as a back-stop for the future federal-aid funds (back-stopped GARVEES). The GARVEE bonds issued under this act's authority must be non-recourse GARVEES. The notes issued under this authority are not supported by a pledge of the taxing power of the State and they must contain on their face a statement to the effect that the State of North Carolina is not obligated to pay the principal or the interest on the notes, except from the federal transportation fund revenues. The act also specifies that the bond revenues must be distributed in accordance with the equity distribution formula under G.S. 136-17.2A.[67] This part of the act becomes effective February 1, 2006; DOT may not issue GARVEE bonds before that date.

The act directs the Department of Transportation and the State Treasurer to form a committee to develop a plan to address the issues involved in issuing GARVEE bonds. The plan must be submitted to the Board of Transportation for review and comment. The final plan must be submitted by December 1, 2005, to the cochairs of the Transportation Appropriations Subcommittee and the Joint Legislative Transportation Oversight Committee.

The act limits the amount of GARVEE bonds that may be issued by requiring the State Treasurer to determine one of the following before the bonds are issued:

- That the total outstanding principal of the debt does not exceed the total amount of federal transportation funds authorized to the State in the prior federal fiscal year.
- That the maximum annual principal and interest payment of the debt does not exceed 15% of the expected average annual federal revenue for the 7-year period in the most recently adopted Transportation Improvement Program.

[67] The 100 counties in the State are divided into seven distribution regions. G.S. 136-17.2A seeks to ensure that all the regions of the State have a percentage share of the transportation funds as determined by the formula set forth in this statute.

In federal fiscal year 2004, the amount of federal transportation funds authorized for the State was $950 million.[68] Therefore, this act would allow the State to borrow roughly $950 million. The fiscal note assumes that DOT would issue $475 million of debt in February 2006, and $475 million of debt in the spring of 2007. It also assumes that the interest rate would be 4.5% on each of the bond issues and that each bond issue would be paid off over 12 years. Based upon these assumptions, the payments on this debt would be about $1.25 billion.[69] These debt service payments would be funded from federal aid available to the State, and would displace the use of this federal aid for other projects or purposes.

Candidate projects for GARVEE financing are typically larger projects that have the following characteristics:

- They are large enough to merit borrowing rather than pay-as-you-go grant funding, with the costs of delay outweighing the cost of financing.
- They do not have access to a revenue stream (such as local taxes or tolls) and other forms of repayment (such as state appropriations) are not feasible.
- The sponsors (generally state DOTs) are willing to reserve a portion of future year federal-aid highway funds to satisfy debt service requirements.

Unrelated to the GARVEE bond authorization, the act clarifies that the State Treasurer can enter into interest rate swap agreements between bond issues. Under G.S. 159-194, the State Treasurer can enter into swap agreements; however, the language in the definitional part of the article does not mirror the language in the authorizing statute itself. Section 4 of this act modifies the definition of 'governmental unit' to mirror the language in the statute authorizing swap agreements. The State's bond counsel requested this change.

BILL LEE / EXCISE TAX REFUND.

Session Law	*Bill #*	*Sponsor*
S.L. 2005-406	**SB 868**	**Senator Berger of Franklin**

AN ACT TO AMEND THE ENTERPRISE TIER STRUCTURE UNDER THE WILLIAM S. LEE QUALITY JOBS AND BUSINESS EXPANSION ACT AND TO ALLOW FOR A REFUND OF EXCISE TAX ON UNSALABLE CIGARS.

OVERVIEW: The act provides an exception to the tier designation formula under the William S. Lee Quality Jobs and Business Expansion Act, by allowing certain industrial parks located in higher-tiered counties to be treated as if they were located in an enterprise tier one area if the parks meet conditions related to government ownership, size, population of the counties, and Medicaid eligibility within the counties.

The act also gives tobacco products dealers a refund of the excise tax paid on stale or otherwise unsalable cigars returned to the manufacturer.

FISCAL IMPACT: No estimate available.

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[68] The actual federal aid received by the State usually amounts to less than the federal aid authorized. For federal fiscal year 2004, the State received roughly $830 million in federal highway funds.

[69] Based upon an interest rate of 4.5%, roughly $300 million of this amount would be for interest expenses.

EFFECTIVE DATE: Changes to the Bill Lee Act are effective for taxable years beginning on or after January 1, 2005. The refund for unsalable cigars became effective September 1, 2005.

ANALYSIS:

The William S. Lee Quality Jobs and Business Expansion Act (hereinafter Bill Lee Act) was enacted in 1996, effective beginning with the 1996 tax year with a 2002 sunset.[70] The Bill Lee Act is a package of State tax incentives and has been modified in each subsequent year. The incentives are primarily in the form of tax credits for investment in machinery and equipment and real property, for job creation, for worker training, and for research and development. Counties are divided into five economic distress tiers based on the unemployment rate, per capita income, and population growth of the county. For many of the credits, the lower the tier of a county, the more favorable the incentive. The Bill Lee Act requires the Department of Commerce and the Department of Revenue to report periodically on the credits allowed by the Act.

By December 31 of each year, the Department of Commerce is required to assign a tier designation to each of the 100 counties in the State. In order to make these assignments, the Department of Commerce must rank all 100 counties based on the following three factors: the rank of the county in a ranking of counties by average rate of unemployment over the preceding 12 months from lowest to highest, the rank of the county in a ranking of counties by average per capita income over the proceeding 12 months from highest to lowest, and the rank of the county in a ranking of counties by percentage growth in population over the preceding 12 months from highest to lowest. [71] Each of these factors is given equal weight. The Secretary of Commerce is required to use the latest data available in making these calculations. Counties with one of the 10 highest rankings are designated enterprise tier one, the next 15 counties are designated enterprise tier two, the next 25 counties are enterprise tier 3, the next 25 counties are enterprise tier 4, and the remaining counties are enterprise tier 5. There are numerous exceptions to this formula.[72] A county designated as enterprise tier one or two may not be designated a higher tier until it has been at its current tier for at least two consecutive years. Certain lower-population counties also enjoy exceptions that could result in those counties receiving a lower tier designation. Finally, certain industrial parks that are located at one site in two or more counties receive the tier designation of the lower-ranked county. This last exception was added in 1998 (S.L. 1998-55) to promote regional cooperation in industrial development and to avoid an industrial park that is split into two tier designations.

Exception to Tier Structure under Bill Lee Act

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[70] See summary of S.L. 2005-241, Extend JDIG and Bill Lee Act, for discussion of the extension of the Act's sunset.

[71] Prior to the designations for the 2005 calendar year, these ranking were based on longer time periods. Unemployment and per capita income were averaged over three years rather than 12 months. There was no time period specified for measuring population growth, but it was the practice of the Department of Commerce to measure population growth by comparing the most recent estimates of population in the county with the figures derived from the last decennial federal census. See S.L. 2004-202.

[72] S.L. 2005-241 creates an exception for counties with particularly high rates of unemployment and amends the current exception for counties with small populations and high rates of poverty by eliminating the requirement related to the percent of the population living below the poverty level.

Section 1 of this act creates a new exception to the Bill Lee Act tier designation formula. Under this act, sites within certain industrial parks will be able to qualify for enterprise tier one status. In order to take advantage of this exception, all of the following conditions must be satisfied:

- The site is located in an industrial park created by interlocal agreement pursuant to G.S. 158-7.4.
- The industrial park is located, at one or more sites, in at least four contiguous counties.
- At least two of the counties in which the industrial park is located are designated as enterprise tier one areas.
- Four or more units of local government, or a nonprofit corporation owned and controlled by four or more units of local government, own the industrial park.
- In each county in which the industrial park is located, the park has at least 300 developable acres. The term "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-part owner.
- The total population of all the counties in which the industrial park is located is less than 200,000.
- In each county in which the industrial park is located, at least 16.8% of the population was Medicaid eligible for the 2003-2004 fiscal year based on 2003 population estimates.

As of the time the bill was signed into law by the Governor on September 20, 2005, the industrial park in the Kerr-Tar region is the only industrial park that was known to meet the above criteria. It is possible that other counties could enter into similar agreements in order to take advantage of the exception in the future, but the restrictions are so stringent as to make it unlikely that a significant number of high-tiered counties could qualify under this act. The four counties involved in the Kerr-Tar industrial park project are Franklin, Granville, Vance, and Warren. In 2005, Franklin County was an enterprise tier five area; Granville County was an enterprise tier three area; and Vance and Warren Counties were enterprise tier one areas.

Refund of Excise Tax on Unsalable Cigars

Section 2 of this act allows a wholesale dealer or retail dealer who has paid the 2% excise tax on cigars to apply for a refund of the excise tax if the cigars are stale or otherwise unsalable. To obtain the refund, the dealer must return the cigars to the manufacturer and send an application to the Secretary of Revenue accompanied by an affidavit from the manufacturer stating the number of cigars returned to the manufacturer. The amount of the refund is the excise tax paid less the 2% discount.[73] Similar treatment is allowed to a distributor of cigarettes. If the distributor of cigarettes is in possession of stale or otherwise unsalable cigarettes, the distributor may apply for a refund of the tax paid, less the discount allowed on the unsalable cigarettes. This act gives the same refund to dealers in possession of unsalable cigars, but not to other tobacco products.

[73] Under current law, a wholesale dealer or retail dealer of tobacco products who timely pays the excise tax on tobacco products at the rate of 2% of the cost price is eligible for a discount equal to 2% of the tax due. This discount is intended to cover expenses incurred in preparing tax reports and the expense of furnishing a bond.

Before August 1, 2003, distributors and wholesalers who timely paid the excise taxes on cigarettes, other tobacco products, wine, beer, and liquor were eligible for a discount equal to 4% of the tax due. In 2003, the General Assembly eliminated these discounts. (S.L. 2003-284). In 2004, the General Assembly reinstated the discounts, but at a rate of 2% of the tax due. (S.L. 2004-84)

TAX INCREMENT FINANCING CHANGES.

Session Law	*Bill #*	*Sponsor*
S.L. 2005-407	**SB 528**	**Senator Clodfelter**

AN ACT TO ALLOW A MUNICIPALITY TO USE PROJECT DEVELOPMENT FINANCING FOR TOURISM-RELATED DEVELOPMENT PROJECTS LOCATED IN AN ENTERPRISE TIER ONE AREA.

OVERVIEW: This act allows a municipality to use project development financing for a tourism-related development project located outside its central business district if the project is located in an enterprise tier one area.

FISCAL IMPACT: The act does not affect General Fund revenues.

EFFECTIVE DATE: The act became effective when it was signed into law by the Governor on September 20, 2005.

ANALYSIS: In November 2004, the voters approved a constitutional amendment that has enabled counties, cities, and towns to use project development financing for the public portion of certain economic development projects within a defined territorial area. Project development financing, also known as tax increment financing, allows a local government to issue bonds secured by the incremental property tax increase generated by the development financed. This financing mechanism can be used for airports, auditoriums and arenas, hospitals, museums, parking facilities, sewer systems, storm sewers and flood control facilities, water systems, street improvements, public transportation facilities, railroads, affordable housing, land development for industrial or commercial purposes, utilities, and redevelopment. The prior law restricted the amount of retail development that could be considered as a 'development project' if the project was located outside a municipality's central business district. Under that restriction, no more than 20% of a project's square footage may be proposed for use in retail sales, hotels, and other commercial uses other than office space.

The act enables municipalities to use project development financing for tourism related development in an enterprise tier one area by eliminating the 20% limitation on commercial uses for tourism-related economic development, such as developments that would feature facilities for exhibitions, athletic and cultural events, show and public gatherings, racing facilities, parks and recreation facilities, art galleries, museums, and art cents.

The act was enacted to give the City of Roanoke Rapids the opportunity to develop a music theater and entertainment district that could become a nationally recognized travel destination in North Carolina. The proposed district will encompass over 700 acres, represents an investment of an estimated $129 million, and should create over 2,595 new jobs. The district will consist of music theaters, shopping, hotels, motels, restaurants, and family recreational activities. The City of Roanoke Rapids has agreed to provide certain improvements in the proposed district and believes project development financing will be a desirable vehicle for it to use to finance these improvements. However, because the project will be located on I-95, outside the City's central

business district, the 20% limitation on commercial development prevented the City from using this financing tool. The act alleviates this problem by eliminating the 20% limitation.

ENERGY CREDIT BANKING/SELLING PROGRAM/FUND.

Session Law	*Bill #*	*Sponsor*
S.L. 2005-413	**SB 1149**	**Senator Jenkins**

AN ACT TO ESTABLISH A BANKING AND SELLING PROGRAM FOR CREDITS ISSUED UNDER THE FEDERAL ENERGY POLICY ACT IN ORDER TO GENERATE FUNDS FOR THE USE OF ALTERNATIVE FUELS AND ALTERNATIVE FUELED VEHICLES BY STATE DEPARTMENTS, INSTITUTIONS, AND AGENCIES AND TO EXTEND AND EXPAND THE CREDIT FOR INVESTMENT IN RENEWABLE ENERGY PROPERTY.

OVERVIEW: This act[74] extends and expands the tax credit for investing in renewable energy property as follows:

- Expands the definition of renewable energy property in G.S. 105-129.15(7) to include any biomass equipment that uses renewable biomass resources for commercial thermal or electrical generation.
- Expands the definition of renewable biomass resources in G.S. 105-129.15(6) to include spent pulping liquor.
- Increases the ceiling on the tax credit for placing renewable energy property in service for nonresidential property from $250,000 to $2.5 million.
- Includes pool heating in the residential property ceiling for solar energy equipment.
- Extends the sunset on the tax credit for investing in renewable energy property from January 1, 2006, to January 1, 2011.

FISCAL IMPACT: The following General Fund loss is estimated as a result of the extension and expansion of the renewable energy tax credit:

Fiscal Year	Business	Individuals	Total
2005-06	$0.00	$0.00	$0.00
2006-07	$0.02 million	$0.08 million	$0.10 million
2007-08	$0.92 million	$0.13 million	$1.05 million
2008-09	$1.95 million	$0.18 million	$2.13 million
2009-10	$3.53 million	$0.27 million	$3.80 million
2010-11	$5.36 million	$0.29 million	$5.65 million

The category "business" includes non-profit organizations with participating private entities. The above revenue losses reflect current usage of the credit. The loss is expected to be higher in the future if energy costs continue to rise.
(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2005 Session. Available in the Legislative Library.)

[74] Changes to the tax credit for investing in renewable energy property are set out in sections 4 and 5 of the act.

EFFECTIVE DATE: Sections 4 and 5 of the act are effective for taxable years beginning on or after January 1, 2006.

ANALYSIS: In 1977, the General Assembly enacted legislation to provide tax credits for the construction or installation of a solar energy system to a building in North Carolina. In subsequent years tax credits encouraging the installation and use of equipment that takes advantage of other renewable energy resources were enacted. Renewable energy property is equipment that uses the renewable energy sources such as solar radiation, vegetation, organic wastes, moving water, or wind for the following purposes: to heat or cool buildings; to produce hot water, thermal, or process heat; or to generate electricity.

Under current law, the credit for investing in renewable energy property applies to any of the following machinery and equipment or real property:

- Biomass equipment that uses renewable biomass resources for biofuel production of ethanol, methanol, and biodiesel; anaerobic biogas production of methane utilizing agricultural and animal waste or garbage; or commercial thermal or electrical generation from renewable energy crops or wood waste materials. Renewable biomass resources are organic matters produced by terrestrial and aquatic plants and animals, such as standing vegetation, forestry and agricultural residues, landfill wastes, and animal wastes.
- Hydroelectric generators
- Solar energy equipment
- Wind equipment

The act adds spent pulping liquor to the definition of renewable biomass resources. Spent pulping liquor is a byproduct of pulp and paper processing. To accommodate this addition to the definition of renewable biomass resources, the act also expands the definition of renewable energy property to include any biomass equipment that uses renewable biomass resources (not just renewable energy crops or wood waste materials) for commercial thermal or electrical generation.

The amount of the credit for investing in renewable energy property is 35% of the cost of the property placed in service. In the case of renewable energy property that services a single-family dwelling, the credit must be taken for the taxable year in which the property is placed in service. For all other renewable energy property, the credit must be taken in five equal installments, beginning with the taxable year in which the property is placed in service. The credit may not exceed the following amounts:

TYPE OF PROPERTY	MAXIMUM CREDIT
Non residential property	The act increases the credit from $250,000 per installation to $2,500,000 per installation
Residential property – Solar energy equipment for domestic water heating. The act clarifies that the credit also applies to solar energy equipment for pool heating.	$1,400 per dwelling unit
Residential property – Solar energy equipment for active space heating,	$3,500 per dwelling unit

combined active space and domestic hot water systems, and passive space heating.	
Residential property – All other renewable energy property for residential purposes	$10,500 per installation

The renewable energy tax credit has the following limitations and conditions:

- The renewable energy tax credit may not exceed 50% of the tax against which it is claimed for the taxable year. Any unused portion of the credit may be carried forward for the succeeding five years.
- A taxpayer that claims any other credit allowed with respect to renewable energy property may not take the renewable energy tax credit with respect to the same property.
- A taxpayer may not take the renewable energy tax credit if the taxpayer leases the property from another person, unless the taxpayer obtains the lessor's written certification that the lessor will not claim a credit with respect to this property.
- The Department of Revenue must report each year on the number of taxpayers claiming the credits, the cost of the property for which the credits were claimed, and the total cost to the General Fund of the credits claimed.

The act extends the sunset on the renewable energy tax credit from January 1, 2006 to January 1, 2011, and maintains the existing sunsets on the other credits in Article 3B (Business and Energy Tax Credits) of Chapter 105 of the General Statutes.

ECONOMIC DEVELOPMENT - PUBLIC RECORDS.

Session Law	*Bill #*	*Sponsor*
S.L. 2005-429	**SB 393**	**Senator Hoyle**

AN ACT TO CLARIFY THE PUBLIC RECORDS LAWS WITH RESPECT TO ECONOMIC DEVELOPMENT AND TO REQUIRE THE DEPARTMENT OF REVENUE TO PUBLISH ANNUAL REPORTS REGARDING USE OF ECONOMIC DEVELOPMENT TAX INCENTIVES.

OVERVIEW: This act requires the Department of Revenue to annually publish a list, itemized by taxpayer, disclosing information about certain tax incentives. In addition, the act clarifies that public records created with respect to a proposed location or expansion of a specific business or industrial project must be released once the project has been announced, that certain types of information are public records, and that an agency must notify applicants for and recipients of economic development incentives about public records requirements.

FISCAL IMPACT: No impact.

EFFECTIVE DATE: The annual reporting required by the Department of Revenue becomes effective January 1, 2007; the remainder of the act became effective when the Governor signed it into law on September 22, 2005.

ANALYSIS: Generally, documents prepared or received by State agencies in the transaction of public business are public records and must be made available to the public for inspection. There are several important exceptions to the public records law that allow for withholding certain public records from disclosure. One of these exemptions is for tax information, which

may be disclosed only as specifically authorized by law. Another of these exceptions relates to the location or expansion of business or industrial projects. Prior to this act, public records relating to the location or expansion of specific business or industrial projects could be withheld from disclosure so long as that disclosure would frustrate the purpose for which the public records were created. Arguably, the release of public records related to a specific project could "frustrate the purpose for which they were created" long after the project was announced.

This act clarifies that public records created with respect to the location or expansion of a specific business or industrial project may not be withheld once the project location or expansion has been announced. The act provides for a 25-business-day period for the State agency to gather and review the records before making them public. The act also specifies that when an agency is required to perform a cost-benefit analysis or similar assessment with respect to economic development incentives offered to a specific business, the assumptions and methodologies used in completing that analysis are public records and must be disclosed in the same fashion as other public records. The act requires an agency to notify the applicant or recipient of economic development incentives about these public records law requirements.

In addition to clarifying the public records law as it pertains to economic development incentives, the act creates and expands reporting requirements surrounding economic development incentives. Under the act, the Department of Commerce must make an annual report on all grant programs administered by the Department; it must specifically disclose the amount transferred to the Utility Account of the Industrial Development Fund under the JDIG Program[75] each year; and it must report employment levels for businesses receiving grants under the JDIG Program.

The Department of Revenue currently publishes an annual report, itemized by taxpayer, on credits claimed under the Bill Lee Act. It also makes annual reports on other credits to either the Revenue Laws Study Committee or the Fiscal Research Division. This act requires the Department to annually publish a report on economic development tax incentives authorized by the State. The act modifies the Department's current reporting requirements so that all reports prepared by it on credits and refunds have identical reporting dates and data periods. It amends the existing reporting requirements for the following credits to require that they be itemized by taxpayer:

- Tax incentives for recycling facilities under Article 3C of Chapter 105.
- Research and development under Article 3F of Chapter 105.

It creates new reporting requirements for the following tax incentives:

- Historic rehabilitation tax credits under Article 3D of Chapter 105.
- Tax incentives for major computer manufacturing facilities under Article 3G of Chapter 105.
- Credit for North Carolina State Ports Authority wharfage, handling, and throughput charges.
- Credit for manufacturing cigarettes for exportation.
- Sales tax refunds for building materials of certain industrial facilities.

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[75] Job Development Investment Grant Program. Part 2G of Article 10 of Chapter 143B of the North Carolina General Statutes.

Lastly, the act directs the newly formed Economic Development Oversight Committee[76] to study the issue of public disclosure as it relates to economic development efforts. Specifically, the Committee shall study ways of providing the public information about employment levels at businesses that receive economic development incentives.

MOTOR FUEL TAX CHGS & REV LAWS TECHNICAL CHGS.

Session Law	*Bill #*	*Sponsor*
S.L. 2005-435	**HB 105**	**Representative Luebke**

AN ACT TO MODIFY THE TAXATION OF MOTOR FUELS, TO MAKE TECHNICAL, CLARIFYING, AND ADMINISTRATIVE CHANGES TO THE REVENUE LAWS AND RELATED STATUTES, AND TO ALLOW INTERSTATE PASSENGER AIR CARRIERS A REFUND OF SALES AND USE TAXES ON FUEL.

OVERVIEW: This act makes numerous changes to the motor fuels tax laws as recommended by the Revenue Laws Study Committee, makes technical and clarifying changes to the revenue laws[77] and allows for a refund of sales and use taxes paid on certain aviation fuel.

FISCAL IMPACT:

Provision	*Fiscal Impact*
Part I. Motor Fuel Tax Changes	
Penalty provisions.	Generally, no estimate is available of the fiscal impact of the various penalties authorized or increased in this Part, but the effect is expected to be minimal.
Red Cross exemption from motor fuels tax.	Since this section conforms statute to department policy, no fiscal impact is expected.
Refund conformity.	No fiscal impact is expected.
IRP audit responsibility.	No additional funding required for the positions with auditing responsibility. Additionally, there is no increase in receipts needed for the department to administer the new or revised statutory requirements resulting from this legislation. The remaining sections deal with record keeping requirements and have no fiscal impact.
Part II. Revenue Laws Technical Changes	A review of the language of the changes to the tax law indicates that they are purely technical in nature. In many cases the new language conforms to the current administrative interpretation. No fiscal impact is expected.
Part III. Refund of Sales and Use Taxes on Fuel	
Interstate air passenger carriers.	Based on historic fuel refund data and projected fuel costs, Tax Research and Fiscal Research agree that the provision is likely to cost the State between $3.0 and $5.0 million each

[76] Created by S.L. 2005-241.

[77] The Revenue Laws Study Committee recommended numerous technical corrections on S 159 that were incorporated into this bill.

	year the program is in effect. The change is expected to impact a fairly limited number of air carriers.
Motorsports racing teams and sanctioning bodies.	Based on data provided by some of the motorsports teams, and information gleaned from recent industry impact studies by UNC Charlotte, Fiscal Research estimates the annual State cost of this portion of the bill as approximately $1.1 million for each of the two years. The local cost is expected to be $0.6 million.

(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2005 Session. Available in the Legislative Library.)

EFFECTIVE DATE: Except as otherwise specified, this act became effective when signed into law by the Governor on September 27, 2005.

ANALYSIS:

Part I: Motor Fuel Tax Changes.

Section	Explanation
1	Penalty for failure to obtain a license. – Allows the Secretary to impose a $1,000 penalty for failure to obtain a license under G.S. 105-449.65 or G.S. 105-449.131[78] Under existing law, the Secretary has general authority to impose a penalty for failure to obtain a license. Under that general authority, the amount of the penalty imposed is equal to 5% of the amount prescribed for the license for each month the taxpayer fails to obtain the license, with a maximum penalty of 25% of the amount prescribed for the license. Because this general authority limits the penalty to a percentage of the amount prescribed for the license, it effectively bars assessing a penalty when there is no charge to obtain a license. There is no charge for the licenses issued pursuant to G.S. 105-449.65 or G.S. 105-449.131. This provision becomes effective January 1, 2006.
2	Electronic funds transfer. – Enables the Motor Fuels Division to move towards a paperless return by requiring those taxpayers who file electronically to also pay electronically. By statute the Secretary can require motor fuels taxpayers to file returns electronically. The Division plans to require motor

[78] G.S. 105-449.65 is contained in the Article dealing with gasoline, diesel fuel, and blended fuel, and requires the following to have a license: refiners, suppliers, terminal operators, importers, exporters, blenders, motor fuel transporters, and distributors who purchase motor fuel from an elective or permissive supplier at an out-of-state terminal for import into this State. G.S. 105-449.131 is contained in the Article dealing with alternative fuels and requires the following to have a license: providers of alternative fuel, bulk-end users, and retailers.

	fuel taxpayers that have schedule data information to file their returns electronically. "Schedule data information" is a separate schedule that lists all bills of lading for the fuel being reported. The information enables the Department to track fuel on a load-by-load basis. The Secretary will not require electronic filing from taxpayers who make a written request for relief from this requirement.
3	Conform refund provisions. – Conforms the refund statute applicable to motor carriers to the general rule applicable to tax refunds of overpaid taxes. Under the general administrative provisions of G.S. 105-266(a)(3), the Secretary does not have to refund a tax overpayment of less than $3.00 unless the taxpayer makes a written request for the refund. A motor carrier is entitled to a credit on its quarterly report for tax paid by the carrier on fuel purchased in this State. If the credit exceeds the amount of tax owed, the statute provides that the Secretary must refund the excess to the carrier. The statute does not set a minimum amount. This statute appears to conflict with the general administrative provision. This section clarifies that the general administrative law applicable to refunds applies to refunds payable to motor carriers.
4	Technical change. – Removes obsolete language to conform to current administrative practice. G.S. 105-449.44 establishes the calculation by which a motor carrier determines the amount of fuel used in North Carolina. The formula under previous law had not been used since 1991. In 1992, North Carolina became a participant in the International Fuel Tax Agreement. The method specified by this section conforms to the IFTA agreement and is the method motor carriers have been using to determine the amount of fuel used in this State since 1992.
5 and 22	Conforming change. – Transfers audit functions related to the International Registration Plan from the Department of Transportation, Division of Motor Vehicles to the Department of Revenue, Motor Fuels Tax Division. The International Registration Plan is the mechanism through which interstate motor carriers are licensed. It helps to ensure that the proper amount of motor fuels tax is credited to each jurisdiction in which the motor carrier travels. It has been suggested that the Department of Revenue has more expertise in auditing taxpayers and would be a more appropriate home for these audit functions. The positions associated with these audit functions were transferred July 1, 2004, through an administrative transfer.
6	Technical change. – Removes language that is no longer applicable. G.S. 105-449.47 provides that the Secretary must issue identification markers to motor carriers. Under previous law, the statute provided that the Secretary could withhold an identification marker if a motor carrier failed to comply with former Article 36 or 36A. The General Assembly repealed those articles in 1996. The authority of the Department to issue an assessment under one of those articles has expired and any uncollectible assessments issued under those articles has been written off. Therefore, the language repealed by this section is obsolete.
7	Reasons to refuse to register and issue identification marker to motor carrier. – Sets forth the reasons the Secretary could refuse to register and issue an identification marker to a motor carrier. The Department requested this change to enable it to register only applicants that are in good standing

	with North Carolina and other taxing jurisdictions. The statute created in this section is very similar to G.S. 105-449.73, which sets forth the reasons the Secretary may refuse to issue a license to an applicant under the motor fuel statutes. This provision becomes effective January 1, 2006.
8	Simplify criminal penalty. – Simplifies the criminal penalty imposed on persons who operate as a motor carrier in this State without obtaining the necessary registration and identification markers. A violation of the motor carrier requirements is a Class 3 misdemeanor. Under previous law it was punishable by a fine that was no less than $10 nor more than $200. This section sets the amount of the fine at $200. The civil penalty for this offense is $100. This provision becomes effective January 1, 2006.
9	Clarification of licensing requirements for multiple activities. – Clarifies the current licensing requirements by conforming them to the current Department policy and practice. This provision becomes effective January 1, 2006.
10	Technical change. – Removes obsolete language. In 1999, the General Assembly removed the licensing requirements for bulk-end users and retailers of undyed diesel fuel. The legislation did not include a conforming change to G.S. 105-449.69(b).
11	Clarifying change. – Changes the defined term "overdue tax debt" to the appropriate defined term "tax debt". Under the general administrative provisions in G.S. 105-243.1, a tax debt is defined as the total amount of tax, penalty, and interest due for which a notice of final assessment has been mailed to the taxpayer after the taxpayer no longer has the right to contest the debt. An "overdue tax debt" is any part of a tax debt that remains unpaid 90 days or more after the notice of final assessment was mailed to the taxpayer. A collection assistance fee is imposed on an overdue tax debt that remains unpaid 30 days or more after the appropriate fee notice is mailed to the taxpayer. G.S. 105-449.73 sets forth the reasons the Secretary can deny a license to an applicant. One of the reasons is failure to remit taxes that remain due after a taxpayer no longer has the right to contest the tax debt. Since G.S. 105-449.73 has nothing to do with the imposition of the collection assistance fee, the term "overdue tax debt" is not the appropriate term to use.
12	Conforming change. – Exempts motor fuel acquired to operate a highway vehicle owned by or leased to the American Red Cross from the motor fuel excise tax. In Department of Employment v. United States, 385 U.S. 355, 87 S.Ct. 464 (1966), the United States Supreme Court ruled that the Red Cross is an instrumentality of the United States for state tax immunity purposes. This provision codifies the current administrative practice of the Department of Revenue. This section makes another conforming change by recognizing that federal law no longer allows dyed diesel fuel to be used in intercity buses. Dyed diesel fuel indicates that the fuel is used for a nontaxable purpose under federal law. Because dyed diesel fuel may no longer be used in intercity buses under federal law, there is no need to specifically apply the State tax to dyed diesel fuel used in intercity buses. This amendment does not change the taxation of the fuel used in intercity buses: the State tax continues to apply.

13	Repeal obsolete payment procedure. – Removes the ability of a person exporting motor fuel to another state to pay the tax directly to the Department if the person is not licensed in the destination state of the motor fuel. The provision is repealed because it is no longer necessary. This provision was included in the statutes in 1996 when North Carolina first adopted "tax at the rack" to accommodate persons exporting products to a state that was not a "tax at the rack" state. Today, with the exception of Georgia, all of the surrounding states have adopted "tax at the rack". The Georgia border in the western part of the State would not be affected by this repeal because the closest terminal to the Georgia line is in Charlotte.
14	Conforming change. – Provides that a supplier must list on its return to the Secretary the number of gallons of motor fuel the supplier exchanged with another licensed supplier pursuant to a two-party exchange agreement. The Secretary currently requires this information on the supplier return.
15	Technical change. – Removes obsolete language from the catch line of G.S. 105-449.106. In 2003, the General Assembly exempted motor fuel sold to a county or city for its use from the motor fuel tax. Although the legislation authorizing the exemption made the appropriate conforming change to the refund statute, it failed to amend the catch line. This provision becomes effective when it becomes law.
16	Shipping document. – Allows the Secretary of Revenue to assess a penalty of $5,000 on a terminal operator who intentionally fails to issue a shipping document that satisfies the requirements for the shipping document. Under G.S. 105-449.115, shipping documents issued by a terminal operator must contain the following information: 1) identification of the terminal or bulk plant from which the fuel was received, 2) the date the fuel was loaded, 3) the gross gallons loaded, 4) the destination state of the motor fuel, 5) the net gallons loaded, and 6) a tax responsibility statement indicating the name of the supplier that is responsible for the tax. The Motor Fuels Tax Division has noticed a problem with some terminal operators failing to issue proper shipping documents. Without an accurate shipping document, it is difficult, if not impossible, for the Department to ensure that the proper amount of tax is being paid. This provision becomes effective January 1, 2006. This section also adds a 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. In order for this defense to be applicable, the person must notify the Secretary of the diversion within 7 days after the diversion occurred and must have timely paid the tax on the diverted fuel. This part of the section becomes effective when it becomes law and applies to penalties imposed on or after January 1, 2005. Finally, this section also specifies that a civil penalty assessed against a transporter is to be paid to the Department of Crime Control and Public Safety or the Department of Revenue. Previously, the penalty could be paid to the Division of Motor Vehicles of the Department of Transportation rather than the Department of Crime Control and Public Safety. This change reflects a recent realignment of enforcement responsibilities.
17	Documentation for tank wagon. –Requires the same documentation requirements for a person who operates a tank wagon into which motor fuel

	is loaded at the terminal as for a person who operates a transport truck into which motor fuel is loaded at the terminal. It would also require that a copy of the invoice be kept at a centralized place of business for at least three years from the date of delivery.
18	Penalty for failing to properly mark storage facility. – Imposes a civil penalty on a person who intentionally does not properly mark the storage facility of motor fuel. Undyed fuel is subject to the motor fuel tax; dyed fuel is not. This section also specifies that a civil penalty assessed against the person failing to properly mark a storage facility is to be paid to the Department of Crime Control and Public Safety or the Department of Revenue. Previously, the penalty could be paid to the Division of Motor Vehicles of the Department of Transportation rather than the Department of Crime Control and Public Safety. This change reflects a recent realignment of enforcement responsibilities. This section becomes effective January 1, 2006
19 and 20	Conforming change. – Makes changes to Chapter 119 necessitated by legislation enacted in 2003. In 2003, the General Assembly voted to apply the inspection tax to dyed diesel fuels. The inspection tax is imposed on all fuel types at the rate of ¼¢ per gallon. Proceeds of the tax are used to offset the expenses of administering the motor fuels taxes. The changes in these two sections are needed to apply the tax to distributors who purchase only dyed diesel fuel.
21	Technical change. – The law provides that an applicant for a license as a kerosene supplier, kerosene distributor, or a kerosene terminal operation may file either a bond with the Secretary of Revenue or an irrevocable letter of credit. Section 21 inserts the phrase "irrevocable letter of credit" in a sentence in which it was inadvertently omitted.
23	Effective date section for this part.

Part II. Revenue Laws Technical Changes.

Section	Explanation
24	Technical change. – Adds language regarding a federal determination of gross estate tax that changes the amount of tax payable to the State. The current statute refers only to a federal correction or determination made with regard to the maximum state death tax credit allowed. As of January 1, 2005, there is no state death tax credit allowed under federal law so language needs to be added regarding gross estate tax changes.
25	Technical change. – Section 25(a) conforms the definition of "unfortified wine" in Chapter 18B to the definition in G.S. 105-113.68. The General Assembly changed the definition of "unfortified wine" in S.L. 2004-135. The definition in Chapter 18B inadvertently included an unnecessary word. Section 25(b) cross-references the applicable definitions in the Alcoholic Beverage License and Excise Tax Article to the definitions in Chapter 18B and makes stylistic changes. In addition, the change made to "wholesaler or importer" conforms to a change made in Chapter 18B in the 2003 Regular Session.
26	Clarifying change. – Clarifies that the excise tax on wine shippers is imposed only on wine shipped to North Carolina consumers.

27	Clarifying change. – Clarifies the scope of authorized disclosure of information obtained by the Secretary of Revenue under Article 2D, Unauthorized Substance Taxes. Under previous law, information obtained under article 2D was confidential and could not be disclosed, unless the disclosure was made to exchange information with certain law enforcement agencies concerning a tax imposed by the Article. The information could also not be used in a criminal prosecution, other than for a prosecution for a violation of the Article or unless the information was independently obtained. However, the law was somewhat ambiguous about when this disclosure between the Division and law enforcement could take place. Since the Division needs to be able to exchange information with law enforcement in order to assist with the collection of the tax and the intent of the statute was to allow such communication, this section clarifies when this information may be disclosed while preserving a person's Fifth Amendment and double jeopardy protections.
28	Clarifying change. – Clarifies that the jobs tax credit installments end if the number of jobs in this State fall below the number the taxpayer had in this State when the taxpayer claimed the credit.
29	Technical change. – Substitutes the appropriate reference to "Article, " as opposed to "section."
30	Technical change. – Repeals the sales tax exemption for sales to the North Carolina Museum of Art of paintings and other objects or works of art for public display, the purchases of which are financed in whole or in part by gifts or donations. Effective July 1, 2004, the sales tax refund for State agencies was replaced with a sales tax exemption for all State agencies. Since the NC Museum of Art is a State agency under G.S. 140-5.12, the specific exemption in Chapter 105 is unnecessary. Those sales will be covered by the broader exemption for all State agencies.
31	Clarifying change. – Clarifies that the sales and use tax exemption for free distribution periodicals, which became effective July 1, 2005, is limited to a publication that is continuously published on a periodic basis monthly or more frequently. The exemption does not apply to publications that are published monthly part of the year and less than monthly the rest of the year.
32	Administrative change. – Section 32(a) authorizes cities to receive the same information available to counties regarding claims for sales tax refunds filed under G.S. 105-164.14, which authorizes refunds for various types of entities, including interstate carriers, nonprofit organizations, certain governmental entities, State agencies, major recycling facilities, nonprofit insurance companies, and certain industrial facilities. These changes were recommendations of a joint county and city task force organized to improve the administration of local sales tax. Section 32(b) excludes from the definition of otherwise confidential tax information, information concerning sales tax refunds paid to governmental entities. It also deletes a reference to information submitted on a master application for a business license since this master application system has been eliminated now that the Business License Information Office has been moved from the Secretary of State to the Department of Commerce.
33	Administrative change. – Section 33(a) provides a sales tax refund for certain building materials used by an air courier. This section allows Fed Ex,

	which plans to construct a facility in North Carolina, to apply for a sales tax refund on its purchases of building materials. The airport authority was going to construct the facility, and it would have been entitled to a refund. However, Fed Ex now plans to construct the facility. This section entitles Fed Ex to the same exemption to which the airport authority would have been entitled. This section became effective August 1, 2005, and applies to sales made on or after that date. Section 33(b) extends the sunset date by six months from July 1, 2009, to January 1, 2010. Section 33(c) removes the sunset language from the effective date part of the 2004 law. Placing the sunset date in the statute reduces the possibility of errors and confusion when and if the relevant subdivisions are amended. This section became effective August 1, 2005.
34	Technical change. – Corrects a grammatical mistake in G.S. 105-113.82(h), 105-116.1(e), and 105-164.44F(e).
35	Technical change. – Deletes the definition of "chlorofluorocarbon refrigerant" from the White Goods Disposal Tax Article because the white goods disposal tax is no longer based on the presence of these materials.
36	Technical change. – Inserts a statutory reference due to a previous recodification. Effective January 1, 1999, the General Assembly repealed the inheritance tax (Article 1, G.S. 105-2 through G.S. 105-32) and replaced it with the current State estate tax system (Article 1A, G.S. 105-32.1 through G.S. 105-32.8.) The new G.S. 105-32.8 preserved the provisions on federal determinations, which had previously been in G.S. 105-29. However, G.S. 105-241.1(e), which sets out the statute of limitations for the Secretary to propose an assessment of tax due, was not updated to include a reference to G.S. 105-32.8.
37	Administrative change. – Makes two changes to G.S. 105-259(b). G.S. 105-259(b) prohibits State employees with access to tax information from disclosing that information to any other person unless the disclosure is for one of the reasons enumerated in that subsection. First, it corrects an agency reference in the tax information confidentiality statute to reflect that the Business License Information Office was moved from the Secretary of State to the Department of Commerce. Second, it adds a new subdivision to allow the Department of Revenue to share with a taxpayer claiming a tax credit under Article 3G (Tax Incentives for Major Computer Manufacturing Facilities), tax information about its related entities and strategic partners.
38	Technical change. – Corrects a statutory reference due to a recodification.
39	Technical change. – Corrects two statutory references due to recodifications.
40	Technical change. – Corrects a statutory reference.
41	Administrative change. – Changes the way in which local sales tax revenues are reported to more accurately account for how the proceeds are distributed. This is a reporting change only and does not change the distribution amounts. Under existing law prior to this act, the first 2% of the local sales taxes on food were considered Article 39 distributions. This section clarifies that the

	taxes distributed on a per capita basis are to be allocated as distributions under Articles 40 and 42, and that the taxes distributed on a point of delivery basis are to be allocated under Article 39. This administrative change makes it easier for local governments to track local sales tax proceeds.
42	Technical change. – Corrects a subsection reference.
43	Technical change. – Deletes an obsolete reference.
44	Clarifying change. – Clarifies reimbursement language with regard to the requirement that State and local agencies that acquire land for wetlands mitigation reimburse the county in which the land is located for its lost taxes due to the acquisition.
45	Administrative change. – Corrects the dates an occupancy tax return is due and the taxes are due.
46	Administrative change. – Increases the fees for obtaining paper and electronic certificates provided by the Secretary of State's Office for certifying a copy of any filed document relating to a domestic or foreign limited partnership. Prior to the enactment of this act, the fee was $5.00. This section increases the fee to $15.00 for a paper certificate and $10.00 for an electronic certificate. In 2002, the General Assembly increased several fees assessed by the Corporations Division of the Secretary of State's Office, including the fee for obtaining certificates and certified copies of records. In part, the new fee schedule was designed to encourage customers to use the online ordering system. Although the fee change was made for corporations and limited partnerships, a corresponding fee change was not made in the Partnership Act, which has resulted in an inconsistency. This fee increase resolves that inconsistency and makes the fees for corporations and partnerships the same.
47	Clarifying change. – Section 47(a) clarifies that the authorization for the additional local sales tax enacted in S.L. 2004-123 applies only to Dare County. Section 47(b) provides that the original bill, as amended by this act, is effective when it becomes law.
48	Technical change. – Provides that the exception in the tax secrecy statute created to correspond with a change in the law sunsets at the same time as that tax law change.
49	Technical change. – Corrects a session law reference.
50	Technical change. – Corrects the proper name for the National Association for Stock Car Auto Racing, Inc. by substituting "for" for "of."
51	Administrative change. – Repeals the conditional sunset on the gross premiums tax rate on medical service corporations. In 2003, the General Assembly increased the gross premiums tax rate on medical service corporations from 1% to 1.9%, effective January 1, 2004. The legislation also provided a conditional sunset on the increased tax rate once there were no longer any medical service corporations offering anything other than dental service plans. There are only two Article 65 medical service corporations in North Carolina – Blue Cross/Blue Shield and Delta Dental. At the time, Blue Cross/Blue Shield was contemplating converting to for-profit status. In doing so, it would have been subject to the 1.9% rate as well. The conditional sunset would have reduced the rate on

	medical service corporations back to 1%, thus reducing the rate for Delta Dental. In July 2003, Blue Cross/Blue Shield announced its intention not to pursue conversion at this time. Therefore, the conditional sunset language, which was intended to address that issue, is no longer necessary.
52	Technical change. – Reenacts S.L. 2005-120 (House Bill 1056). This bill extended the period of time allowed for the Carteret Board of County Commissioners to develop a plan and sign a contract for the construction of a convention center. It also extends by one year the date for the Board to levy the one percent (1%) room occupancy tax to the year 2008. This bill passed both the House and Senate and was enacted on June 28, 2005. However, the bill was not read on three separate days in the House. The session law is being reenacted in this bill, which is also a roll-call bill, to assure that the bill meets the constitutional roll-call requirement.
53	Technical change. – Corrects a typographical error by replacing the word "of" with the word "or."
54	Technical change. – Corrects a reference in S.L. 2005-233 to "tourism promotion" by changing it to "promote travel and tourism," which is a defined term in the statute.
55	Technical change. – Corrects incorrect statutory reference.
56	Technical change. – Inserts a sentence inadvertently omitted. This section becomes effective January 1, 2006.
57	Clarifying change. – Clarifies that HMOs are taxed at the rate of 1.9%. This section becomes effective January 1, 2007.
58	Clarifying change. – Provides that for prepayments of cable services, the first billing period is considered to start on or after February 1, 2006.
59	Clarifying change. – Clarifies the drama portion of the literary purpose for the property tax exemptions. This change was made in order to clarify the tax status of institutions such as the Carolina Theater in Guilford County.
59.1	Technical change. – Corrects incorrect statutory reference. This section becomes effective January 1, 2006.
59.2	Clarifying change. – Clarifies the application of the franchise tax to a corporation who must include in its franchise tax base the assets of a LLC that pays a franchise tax as an electric power company. Under previous law, G.S. 105-114 provided that a corporation subject to the general franchise tax was liable for the tax only to the extent that the tax exceeded the amount of tax paid by the corporation under any other section of the Article. This limitation did not apply when the taxes were paid indirectly by the corporation through a LLC whose assets were required to be included in the corporation's franchise tax base. This provision allows those taxes paid by the LLC to be treated in the same manner as taxes paid directly by the corporation. This change was made at the request of Duke Power in order to main the current tax treatment of the company once it has completed a corporate merger and restructuring. This section is effective for taxable years beginning on or after January 1, 2006.
60	Effective date section for this part.

Part III: Aviation Fuel Sales Tax Refund.

61	Interstate Passenger Air Carriers. – Under current law, interstate carriers are allowed a refund of a portion of the sales and use taxes paid by the carrier on fuel, lubricants, repair parts, and accessories purchased in this State. The refund is equal to a proportion of the sales and use taxes paid by the carrier in this State. The proportion is equal to the proportion of the miles traveled by the carrier in this State to the total miles traveled by the carrier. This act allows for an additional refund for interstate passenger air carriers.[79] The act allows for a refund of any amount of sales and use taxes paid by the taxpayer on fuel that exceeds $2.5 million, after taking into consideration the other refund allowed to the interstate passenger air carrier. The refund allowed by this section must be claimed on an annual basis on a form developed by the Secretary of Revenue. The change was made to encourage US Airways to maintain a hub at Charlotte Douglas International Airport. It is unknown if other airlines will benefit from this refund as well. The refund applies to purchases of fuel made on or after January 1, 2005, but before January 1, 2007.
61.1	Motorsports. – This section allows for a refund of sales and use taxes on aviation fuel paid by a motorsports racing team or motorsports sanctioning body. In order to qualify for the refund, the fuel must have been used to travel to or from a motorsports event in this State, from this State to a motorsports event in another State, or to this State from a motorsports event in another State. For the purposes of the refund, a "motorsports event" includes a motorsports race, a motorsports sponsor event, and motorsports testing. The refund allowed by this section must be claimed on an annual basis on a form developed by the Secretary of Revenue. The refund applies to purchases of fuel made on or after January 1, 2005, but before January 1, 2007.
62	Effective date section for this part.

[79] An interstate passenger air carrier is defined as "a person whose primary business is scheduled passenger air transportation, as defined in the North American Industry Classification system adopted by the United States Office of Management and Budget, in interstate commerce."

2004

JOB GROWTH AND INFRASTRUCTURE ACT.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-435	**HB 2**	**Representative G. Allen**

AN ACT TO MAKE THE FOLLOWING CHANGES RECOMMENDED BY THE GOVERNOR: (1) APPROPRIATE TWENTY-FOUR MILLION DOLLARS FOR INDUSTRIAL SITE INFRASTRUCTURE FOR MAJOR PROJECTS; (2) MODIFY THE JOB DEVELOPMENT INVESTMENT GRANT PROGRAM; (3) PROVIDE INCENTIVES FOR MAJOR PHARMACEUTICAL AND BIOPROCESSING FACILITIES BY EXTENDING THE BILL LEE ACT SUNSET FOR THESE INDUSTRIES AND AUTHORIZING SALES TAX REFUNDS FOR CONSTRUCTION MATERIALS FOR THESE INDUSTRIES; (4) EXTEND THE SUNSET ON AND MODIFY THE CIGARETTE EXPORTATION TAX CREDIT AND MODIFY THE BASE YEAR, (5) CREATE AN ENHANCED TAX CREDIT FOR CIGARETTE EXPORTATION, AND (6) CREATE A LIFE SCIENCES REVENUE BOND AUTHORITY.

OVERVIEW: This act makes the following economic development changes:

- Appropriates $24 million to a nonreverting fund to be used for site infrastructure for major industrial projects.
- Makes various changes to the Job Development Investment Grant (hereinafter JDIG) Program.
- Extends the William S. Lee Quality Jobs and Business Expansion Act (hereinafter Bill Lee Act) sunset and other deadlines for major pharmaceutical manufacturing and bioprocessing facilities.
- Authorizes annual sales tax refunds for construction materials for major pharmaceutical manufacturing and bioprocessing facilities.
- Extends the sunset on the cigarette exportation tax credit from 2005 to 2018 with the additional requirement that the taxpayer use the North Carolina State Ports. This part also allows the credit to be claimed by successors in business and modifies the base year determination.
- Allows a corporate income tax credit for tobacco manufacturers who export cigarettes to foreign countries, who use the North Carolina State Ports, and who maintain employment levels in this State that exceed the corporation's employment level in this State at the end of 2004.
- Establishes the Life Sciences Revenue Bond Authority to study and make recommendations for creating a credit enhancement program for financing construction of infrastructure for life sciences manufacturing facilities.

FISCAL IMPACT:

Description and Effective Dates	General Fund Impact
Expansion of Bill Lee Credits	$1 million loss beginning in 2007-2008
Major Industrial Facility Sales Tax Refunds	$1.5 million loss for 2005-2006 $2.3 million loss for 2006-2007 $2.6 million loss for 2007-2008 Will also create local government revenue losses
Changes to the existing cigarette exportation tax credit	$12 million loss for 2005-2006 $12 million loss for 2006-2007 $12 million loss for 2007-2008
New enhanced cigarette exportation tax credit	$4 million loss for 2006-2007 $4 million loss for 2007-2008.

(For a more compete fiscal analysis, see Overview Fiscal and Budgetary Actions, 2004 Session. Available in the Legislative Library)

EFFECTIVE DATE: *See Analysis for effective dates.*

ANALYSIS: The Governor convened the Second Extra Session of the 2003 General Assembly to consider specific economic development changes. The following changes were enacted:

Major Industrial Site Infrastructure

Part 1 of the act creates a nonreverting Site Infrastructure Development Fund in the Department of Commerce to fund site acquisition and development and other capital expenses related to major industrial development.[1] The act appropriates $24 million to the Fund for the 2003-2004 fiscal year. A Site Infrastructure Development incentive may be in the form of a restricted grant or forgivable loan directly to a business or a grant to a government or nonprofit agency to administer the incentive.

Projects built with this appropriation are exempted from State construction requirements and State purchase requirements, with one exception. When public funds are expended, the State's policy of minority participation and the State's minority participation goal of 10% apply. Projects are also exempted from the part of the State Environmental Policy Act that requires detailed environmental impact statements when public funds or public lands are used for projects and programs significantly affecting the quality of the environment.

Eligible businesses may apply for site development incentives. To qualify for the incentive, a business must employ at least 100 new full-time employees and invest at least $100 million of private funds in the project. A business must also provide health insurance for its full-time employees and have a history of compliance with the Occupational Safety and Health Act and programs implemented by the Department of Environment and Natural Resources.

The Department of Commerce and the Economic Investment Committee[2] will administer the selection process, including developing appropriate criteria for evaluating applicants. Section

[1] Section 6.26 of S.L. 2004-124, the 2004 Appropriation Act, amended the Fund to also allow moneys in the Fund to be used to acquire options and hold options for the purchase of land for an anticipated industrial site if certain conditions are met.

[2] The Economic Investment Committee, which administers the JDIG program, is a five-member committee consisting of the Secretary of Commerce, the Secretary of Revenue, the Director of the Office of State Budget and Management, one member appointed by the General Assembly upon the recommendation

1.3 of the act exempts them from rulemaking procedures in administrating the site infrastructure development program. Before recommending a project for site development, the Committee must make several findings, including a finding that site development is necessary for completion of the project in this State and a finding that the price to be paid for the site is appropriate and not excessive. Section 1.4 of the act provides that the JDIG conflict of interest restrictions will apply to the site infrastructure development program as well.[3]

Once an incentive is awarded, the Department will enter into an agreement with the business to provide site development within available funds. The agreement must include a provision prohibiting a business from receiving a payment or other benefit under the agreement when the business has received notice of an overdue tax debt and the overdue tax debt has not been satisfied or otherwise resolved. The agreement is binding on both parties. The agreement must include performance criteria, remedies, and other safeguards to protect the State's investment. The Attorney General must review and approve each agreement.

After a site development incentive is in effect, the Department of Commerce is responsible for monitoring the business' compliance with performance criteria and for administering the repayment of State funds by a business that has failed to meet these criteria. The Department of Commerce is required to report quarterly to the Joint Select Commission on Governmental Operations on the details of the program, including projects that receive incentives and any defaults and repayments. This report must also be made available to the public.

Part 1 of the act became effective when signed into law by the Governor on December 16, 2003.

Job Development Investment Grant Changes

Part 2 of the act makes several changes to the JDIG program.[4] Section 2.2 provides that, in determining whether a business has increased or maintained employment, the Economic Investment Committee can decide to look at a division or unit of a business rather than the entire business. Choosing this option means that if the entire business decreases employment, it may still qualify for a grant for a division or unit within the business that increases employment. The Committee can choose this option only if it is necessary to secure the project and the community economic development agreement contains terms to assure that the business does not create eligibility by transferring existing jobs to the project.

Section 2.3 of the act repeals the wage standard as it applies to the JDIG program. There were several reasons for this change. First, at the time a business applies for a JDIG grant, the wages to be paid are just projections. Second, the law had been interpreted to require the jobs to meet not only the current wage standard, but also future wage standards, which can fluctuate annually. This interpretation created a great deal of uncertainty as to the prospect of actually receiving a grant in future years of the agreement. Third, while there is no wage standard for

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of the Speaker of the House of Representatives, and one member appointed by the General Assembly upon the recommendation of the President Pro Tempore of the Senate.

[3] Members of the Economic Investment Committee are forbidden to work for a business that receives a grant or loan under the program for at least two years after the member is no longer on the Committee. A former member of the Committee who violates this prohibition must forfeit any compensation received for that work and is prohibited for an additional two years from working for a business that receives a grant under the program.

[4] The 2004 Appropriation Act made subsequent changes to the JDIG program. A description of the program and the changes made by the 2004 Act are described in the analysis of S.L. 2004-124, the 2004 Appropriations Act.

tiers one and two and the wage standard is set below the county average for prosperous tier five counties, the mid-range counties had to meet the actual county average. With sudden and severe dislocation, the wage standard could have blocked incentives for a project that would be vital to economic recovery for a county suffering from the loss of manufacturing industries. Finally, because grants are awarded at the discretion of the Committee, the Committee can use its judgment to assure that grants are not awarded to inappropriate, low-wage projects.

Sections 2.1, 2.4, and 2.5 of the act are more technical. Section 2.1 clarifies that the base period for measuring performance under a grant agreement can be any 24 months starting when performance begins. This base period is not limited to calendar years. Section 2.1 also adds the definition of enterprise tier to the statute. Section 2.4 clarifies the procedure for public notice and public comment on proposed changes to the JDIG criteria. Section 2.5 clarifies that payments under a grant can begin on a future date after it is awarded, as long as they begin within six years.

Part 2 became effective when the act was signed into law by the Governor on December 16, 2003.

Extend Bill Lee Credits for Certain Major Industries

In 2002, the General Assembly extended the sunset date on the Bill Lee Act until January 1, 2010, for certain interstate air couriers and also increased various time frames in the Bill Lee Act from two years to seven years.[5] The rationale for these extensions was that the interstate air courier industry and the construction of a hub in particular, face many regulatory, administrative, and legal hurdles not generally faced by other industries. Due to these extra burdens, there is generally a longer period between the time a project is announced and a location is selected and the time the facility is placed in service.

Part 3 of the act makes the same extensions for eligible major industries, effective beginning with the 2004 taxable year. An eligible major industry is either of the following two industries if the taxpayer will invest at least $100 million in acquiring, constructing, or equipping a facility to engage in the industry:

- Bioprocessing
- Pharmaceutical and Medicine Manufacturing and the Distribution of Pharmaceuticals and Medicines.

If the taxpayer does not in fact invest the required amount, the taxpayer forfeits the benefits of the extensions and must repay the credits.

Major Industrial Facility Sales Tax Refunds[6]

Part 4 of the act creates an annual refund of State and local sales taxes paid on construction materials and fixtures for facilities that involve the investment of more than $100 million by the taxpayer and are primarily used for either of the following two industries:

- Bioprocessing
- Pharmaceutical and Medicine Manufacturing and the Distribution of Pharmaceuticals and Medicines.

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[5] See S.L. 2002-146.

[6] S.L. 2004-124, the 2004 Appropriations Act, expanded this provision.

The taxpayer must apply for the sales tax refund within six months after the end of the State's fiscal year. The refund is effective for sales taxes paid on or after January 1, 2004. If, after obtaining a refund, the taxpayer does not end up investing the required amount, the taxpayer forfeits the refund.

Cigarette Exportation Tax Credit

Part 5 of the act extends for thirteen years the sunset of the corporate income tax credit for manufacturing cigarettes for exportation. As enacted in 1999, this credit is a dollar amount per cigarette exported for those manufacturers who export at least 50% as many cigarettes in the taxable year as they did in calendar year 1998. The dollar amount ranges from forty cents to twenty cents per 1,000 cigarettes exported. The credit is capped at the lesser of $6 million per year or 50% of the manufacturer's corporate tax liability for any given year. The credit was set to sunset for cigarettes exported on or after January 1, 2005. Part 5 of the act changes the sunset to 2018.

Part 5 of the act also makes five other substantive changes to the credit for manufacturing cigarettes for exportation:

- It changes the base year for determining the exportation volume from 1998 to 2003, effective for cigarettes exported on or after January 1, 2005.
- It provides that the taxpayer must export cigarettes through the North Carolina State Ports, effective for cigarettes exported on or after January 1, 2005.
- It allows a successor in business to a corporation that claimed the credit to continue to claim the credit. In this case, the amount of the credit allowed is determined by comparing the exportation volume of the corporation in the year for which the credit is claimed with all of the corporation's predecessor corporations' combined base year exportation volume. This provision is effective for cigarettes exported on or after January 1, 2005.
- It expands the credit by allowing the credit to be claimed for the exportation of cigarettes to a possession of the United States or a commonwealth of the United States that is not a state. This provision is effective for taxable years beginning on or after January 1, 2004.
- It increases the carryforward period of any unused portion of the credit from five to ten years, effective for cigarettes exported on or after January 1, 2005.

Enhanced Cigarette Exportation Tax Credit

Part 6 of the act creates a new, alternative corporate tax credit for tobacco manufacturers who export cigarettes to foreign countries, who use the North Carolina State Ports, and who maintain employment levels in this State that exceed the manufacturer's employment level in this State at the end of 2004 by at least 800 full-time employees.[7] The credit is effective for taxable years beginning on or after January 1, 2006, and expires for exports occurring on or after January 1, 2018.

This new credit is a dollar amount per cigarette exported for those manufacturers who meet the above eligibility requirements. The credit amount is 40¢ per 1,000 cigarettes exported.

[7] Section 16 of S.L. 2004-170 amended the new credit to provide that in determining whether a taxpayer is eligible for the credit, positions located within North Carolina for six months or less are not considered to be part of the taxpayer's employment level.

The credit is capped at the lesser of $10 million per year or 50% of the manufacturer's tax liability for any given year. The credit may be taken against the corporate income tax or the franchise tax, or a combination of the two, at the election of the taxpayer. Once made, an election is binding and applies to all carryforwards of the credit. The taxpayer may, however, make a different election each year for credits earned during that year. Unused portions of a credit may be carried forward for 10 years. Part 6 of the act would also allow a partial credit for taxpayers who had previously met all eligibility requirements but who fail to maintain the required employment level. In computing the partial credit, the credit that would otherwise have been allowed is reduced in proportion to the amount by which the taxpayer's employment level is below the required level.

The credit created in Part 6 of the act differs from the credit allowed under G.S. 105-130.45 in several key ways. This new credit has a higher cap ($10 million as opposed to $6 million) and may be taken against the income tax and/or franchise tax (as opposed to only the income tax). In addition, the new credit requires job creation whereas the credit allowed under G.S. 105-130.45 does not. The new credit applies to cigarettes exported only to foreign countries (as opposed to foreign countries, to possessions of the United States, or to United States commonwealths that are not states) and requires the taxpayer to "export" through the North Carolina Ports (as opposed to "waterborne export" through the North Carolina Ports). A taxpayer may take either the new credit in this part or the original credit in G.S. 105-130.45, but may not claim both credits for the same activity.

While the original cigarette exportation tax credit was being considered during the 1999 Session, the issue was raised as to whether the credit would violate the General Agreement on Tariffs and Trade (GATT). The General Assembly staff was of the opinion that the tax credit would violate GATT, while counsel for one of the four tobacco manufacturers disagreed. This issue has not been resolved with respect to the original credit, and the new tax credit added by this part presents the same issue. It is clear, however, that any challenge to either the original credit or the new credit must come from a foreign government. If a foreign government were to challenge the credit, then the United States Justice Department could sue North Carolina. If the State were to lose, the federal statute provides that relief would be prospective only and persons who had already used the credit could not be required to repay it. Private citizens have no cause of action on the issue.

Life Sciences Revenue Bond Authority

Part 7 of the act creates a Life Sciences Revenue Bond Authority in the Department of State Treasurer, effective when signed into law by the Governor on December 16, 2003.[8] This provision is step one of a two-step process. First, the Authority will study the best method for establishing a credit enhancement program for construction of infrastructure for life sciences manufacturing facilities. After the Authority reports its findings and recommendations to the General Assembly by May 1, 2004, the act anticipates that in the second stage the Authority would administer any program enacted by the General Assembly.[9]

This Part of the act does not require an appropriation. The Authority is expected to perform its duties during the first phase using funds raised from private sources. In addition, the Authority is authorized to charge fees for one part of the study, in which it will accept test

[8] Senate Bill 75, introduced by Senator Rand during the 2003 Session, would also have created the Life Sciences Revenue Bond Authority. The bill was in a conference committee at the end of the 2003 Session.
[9] As of August 2004, no report had been made because the members of the Authority's Board of Directors had not been appointed.

applications (pro forma applications) to evaluate the need for the proposed credit enhancement program. The act directs the Authority to cooperate with appropriate government agencies, the University of North Carolina system, the Biotechnology Center, and others in developing its recommendations.

One example of a credit enhancement vehicle would be revenue bonds. Under existing law, the State and local governments can issue tax-exempt industrial revenue bonds for manufacturing and pollution control facilities. The bonds are retired with payments from the private business that will use the facility. The private business benefits from paying tax-exempt rates, rather than the taxable rates it would pay if it borrowed the money itself. Under Part 7 of the act, the Authority will consider using industrial revenue bonds and other approaches to credit enhancement in order to encourage the expansion of the life sciences manufacturing industry in this State.

The findings portion of Part 7 of the act identifies the life sciences as including biology, zoology, agronomy, biochemistry, genetics, and molecular biology. The commercialization of life sciences products to diagnose and treat diseases and provide other benefits is identified as having significant economic benefit to the State. The stated intent is to encourage the development of the bioprocess manufacturing industries in order to achieve a position of national leadership and innovation in this field.

ALLOW FAMILY BUSINESS TO LEASE FARMLAND.

Session Law	*Bill #*	*Sponsor*
S.L. 2004-8	**HB 1465**	**Representative Brubaker**

AN ACT TO ALLOW FARMLAND OWNED BY A FAMILY BUSINESS TO KEEP ITS PRESENT-USE VALUE TAX STATUS WHEN LEASED FOR FARM USE.

OVERVIEW: This act allows farmland owned by a business entity to keep its present-use value status when the land is leased to a nonmember of the entity, as long as all members of the business entity are relatives and the land is leased for agricultural, horticultural, or forestry purposes.

FISCAL IMPACT: This act addresses a property tax issue, thus no General Fund impact is expected. The act will result in a loss of revenue to local governments; the loss of revenue is expected to be fairly small because of the limited nature of the tax law change. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2004 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The act is effective for taxes imposed for taxable years beginning on or after July 1, 2004.

ANALYSIS: Agricultural land, horticultural land, and forestland that meet certain size, income, and ownership requirements may qualify as a special class of property subject to taxation at its present-use value rather than its fair market value. If the property is owned by a business entity, then the members of the business entity or their relatives must be actively engaged in the business of farming for the property to qualify for the use value program. By contrast, the law does not require a natural person who owns farmland to be actively engaged in the business of farming. In 1987 the Property Tax Commission determined that leasing land

in and of itself does not qualify as 'actively engaged' in the business of farming.[10] This distinction has resulted in a different tax treatment of leased farmland owned by a person and farmland owned by a family business. For example, an individual who owns farmland may negotiate a lease for the land to be farmed by another but a limited liability company's land would lose it use-value status if it were leased to a non-relative.

This act removes this distinction and allows property owned by a family business to keep its present-use value tax status if the members do not want to physically participate in farming the land or to make decisions about the farming activity. The act specifies that the terms "having as its principal business" and "actively engaged in the business of the entity" include the leasing of land for agriculture, horticulture, or forestry as long as all members of the business entity are relatives. As a result of this tax law change, farmland owned by a limited liability company whose members are all related will not lose its present-use value status if one family member, who has been physically farming the land, dies and the surviving relatives decide to lease the land to a nonmember to handle all farming activity.

Under the existing law, a person must file for preferential property tax classifications during the regular listing period, which ends January 31. A county may extend the listing period up to 30 days in nonrevaluation years and 60 days in revaluation years.[11] In addition, for good cause, a county may extend the listing period for a specific taxpayer until April 15. The legislation, which became law on June 17, 2004, did not extend the application deadline. Any application filed after the act became law would be untimely and of no effect for the 2004 tax year. Thus, a taxpayer must have applied for the preferential treatment before the act became law in order to take advantage of the act for the 2004 tax year.[12]

ADOPT FLAT FEE FOR DEBT COLLECTION.

Session Law	*Bill #*	*Sponsor*
S.L. 2004-21	**HB 1497**	**Representative Wainwright**

AN ACT TO ADOPT A FLAT COLLECTION ASSISTANCE FEE UNDER THE SETOFF DEBT COLLECTION ACT.

OVERVIEW: This act, which was a recommendation of the Revenue Laws Study Committee, adopts a flat collection assistance fee of $5.00 for debts collected by the Department of Revenue under the Setoff Debt Collection Act.

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[10] The case before the Property Tax Commission in 1987 involved agricultural land owned by a corporation. The corporation leased the property to a non-member who provided the capital equipment, bore the risks associated with the farming operation, and made the decisions as to the crops to be planted, the equipment needed, and the labor to be hired. The Commission concluded the corporation was engaged in the business of leasing land and was not in the principal business of and actively engaged in the commercial production of growing crops, plants, or animals. The Commission found that the county in that case correctly denied present-use value status to the property.

[11] If a county allows electronic listing of business personal property, it may extend the period for electronic listing until as late as June 1. G.S. 105-307(b).

[12] The use-value law provides an exception to the application deadline in cases where a transfer of property results in eligibility. In those cases, the application may be filed at any time within 60 days after the transfer. G.S. 105-277.4.

FISCAL IMPACT: Not determined. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2004 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act is effective for fees assessed on or after January 1, 2005.

ANALYSIS: This act modifies the Setoff Debt Collection Act by imposing a flat $5.00 collection assistance fee on each debt collected through setoff. Under that Act, if an individual owes money to a State or local agency, the Department of Revenue sends the individual's income tax refund to that agency in payment of the debt rather than to the individual. Thus, the debt the individual owes to the agency is set off against the individual's income tax refund.

The Department of Revenue recovers its costs of running the program by charging a collection assistance fee as a percentage of each debt collected. The fee is added to the debt and paid by the debtor from the refund. Before this act went into effect, the Department would calculate its actual costs for the previous year and adjust the fee amount to reflect those costs.

The change to a flat fee of $5.00 was recommended to the Revenue Laws Study Committee by the Department of Revenue. According to the Department, the process to determine "actual cost" is tedious and quite cumbersome because many different areas of the Department are affected. Thus, the "actual cost" is an estimate at best. The collection assistance fee determined by the Department for the four latest calendar years has been less than $5.00, and collection costs are not expected to grow.

NOTICE PERIOD FOR SALES AND USE TAX REFUNDS.

Session Law	*Bill #*	*Sponsor*
S.L. 2004-22	**HB 1448**	**Representative Luebke**

AN ACT TO REQUIRE THAT SELLERS BE PROVIDED WITH NOTICE AND A SIXTY-DAY PERIOD TO RESPOND TO A REQUEST FOR A REFUND OF OVER-COLLECTED SALES OR USE TAXES BEFORE A PURCHASER MAY BRING A CAUSE OF ACTION AGAINST THE SELLER.

OVERVIEW: This act, which is a recommendation of the Revenue Laws Study Committee, requires a purchaser seeking a refund of over-collected sales or use tax to provide written notice to the seller and to allow the seller 60 days to respond before the purchaser may bring a cause of action against the seller. This requirement is necessary to conform to the Streamlined Sales Tax Agreement.

FISCAL IMPACT: No impact.

EFFECTIVE DATE: This act became effective when signed into law by the Governor on June 25, 2004.

ANALYSIS: Under the Streamlined Sales Tax Agreement, purchasers seeking a refund of over-collected sales or use taxes must give the seller written notice and allow the seller 60 days in which to respond before bringing a cause of action against the seller.

Earlier in 2004, the Department of Revenue adopted this provision as part of a technical bulletin. However, the retailers expressed a preference for having the provision codified in statute. Therefore, the act codifies the Department's policy regarding refund procedures for over-collected sales and use tax.

AMEND FRANCHISE TAX LOOPHOLE.

Session Law	*Bill #*	*Sponsor*
S.L. 2004-74	**SB 51**	**Senator Clodfelter**

AN ACT TO CLOSE A LOOPHOLE THAT ALLOWS CORPORATIONS TO CONTINUE AVOIDING FRANCHISE TAXES AND TO REMOVE PROVISIONS THAT COULD RESULT IN FRANCHISE TAXES ON UNRELATED LIMITED LIABILITY COMPANIES.

OVERVIEW: This act makes several changes to the 2001 and 2002 legislation that established attribution rules intended to close a loophole that allows corporations to escape franchise tax by having a controlled limited liability company (LLC) hold their assets.

- It removes attribution rules for certain related members and for individuals. Ownership interests in LLC assets would be attributed to corporations and to and from partnerships, estates, trusts, LLCs, and other entities.
- It provides that federal rules relating to constructive ownership of stock govern attribution of ownership interests in LLC assets.
- It attributes only a proportion of the LLC assets to the controlling corporation, rather than all of the assets.
- It exempts LLCs that have no more than $150,000 of assets.
- It simplifies and corrects the test for determining whether an LLC's assets are attributable to a corporation.
- Beginning in 2005, it reduces from "70% or more" to "more than 50%" the minimum percentage of an LLC's assets a corporation must control to trigger the franchise tax requirement.
- It removes membership in the LLC as an additional condition for attribution.

FISCAL IMPACT: No estimate available. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2004 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The changes become effective for taxes due on or after January 1, 2003.

ANALYSIS: Under North Carolina law, limited liability companies (LLCs) [13] are not subject to the franchise tax.[14] In 1997, the North Carolina law regarding LLCs was changed to allow for a single-member LLC. This change had the unintended consequence of allowing a corporation subject to North Carolina franchise tax to set up an LLC and transfer assets to the LLC in a tax-free transfer. The assets then held by the LLC would not be subject to the franchise tax.

[13] A limited liability company is a business entity that is essentially a hybrid of a partnership and a corporation. Like a corporation, an LLC limits the liability of its owners. Like a partnership, an LLC is usually not subject to entity-level taxation.

[14] The franchise tax is a tax on S Corporations and C Corporations for the privilege of doing business in the State. The tax rate is $1.50 per $1,000 of value of the greatest of (1) apportioned net book value of the corporation; (2) 55% of appraised value of real and tangible personal property in North Carolina; or (3) total actual investment in tangible property in North Carolina.

Thus, the corporation could avoid a significant portion of its franchise tax liability by transferring assets into a wholly owned LLC without affecting its income tax liability.

In 2001, the General Assembly enacted S.L. 2001-327 to close this loophole. The 2001 legislation tried to address the problem by requiring a corporation to pay tax on assets owned by a LLC if the corporation, including its affiliated corporations, indirectly owned[15] at least 70% of the LLC's assets. Unfortunately, tax planners found that the tax could still be avoided by using an additional paper transaction. If the corporation interposed a partnership between itself and the LLC holding its assets, then technically the 2001 legislation would not apply and the assets would continue to escape franchise tax.

In 2002, the General Assembly enacted S.L. 2002-126 to tighten the 2001 law. The 2002 legislation required attribution through "related members" (other entities and individuals) who may cooperate with one or more corporate entities to own the LLC that will hold the corporate assets. "Related members" is a defined term and includes certain shareholders, partnerships, estates, trusts, and corporations. If a corporation and its related members together indirectly own at least 70% of an LLC's assets, the 2002 legislation provided that each corporation would pay franchise tax on its relative share of the LLC's assets. The relative share was calculated after excluding those related members that are not corporations. Thus, the entire assets were subject to franchise tax, with the tax burden shared proportionally by the corporations involved in the ownership scheme.

After the 2002 legislation was enacted, it became apparent that it not only failed to close the loophole but also extended the franchise tax to situations that did not involve corporate control of LLC assets. The loophole remained open because there were additional paper transactions that can be interposed between the corporation and the LLC in order to circumvent the attribution of the LLC's assets to the corporation. For example, control could be passed through a business trust.[16] The 2002 legislation apparently went too far because it extended the franchise tax to assets owned by individuals or entities over which the corporation has no control.

The 2003 Revenue Laws Study Committee recommended legislation to the 2003 legislative session to correct the LLC franchise tax loophole.[17] The proposal was introduced as Senate Bill 51. Each house passed a version of Senate Bill 51 but they were unable to resolve the differences between the two versions. After the 2003 session adjourned, the Revenue Laws Study Committee appointed a working group including the Department of Revenue, certified public accountants, and tax attorneys, which recommended a new approach that they thought would be effective, workable, and fair. During the 2004 Session, the recommendation was enacted as a conference committee substitute for the 2003 bill, Senate Bill 51.

This act closes the LLC franchise tax loophole by extending the franchise tax to all LLC assets the corporation controls through trusts and other entities. The Revenue Laws Study Committee determined that franchise tax is appropriate if a corporation controls assets owned by a related

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[15] Indirect ownership of an LLC's assets is determined based on who is entitled to receive those assets upon dissolution of the LLC.

[16] A business trust is not considered a related member, as that term is defined in G.S. 105-130.7A, because it would be the corporation, not the shareholders, that would form the trust.

[17] The Department of Revenue, in its 2003 reports to the Revenue Laws Study Committee, noted that there exists a general franchise tax inequity because the imposition of the tax depends on the type of entity. The Governor's Commission to Modernize State Finances recommended that the State impose the franchise tax on all types of business entities, not just on traditional corporations. The Commission recommended that the revenues generated from this base broadening could be used to establish a minimum net worth threshold for payment of the tax.

LLC, but not if the corporation gives up both control and ownership of the assets. By limiting the scope of the 2002 legislation to only those LLC assets the corporation controls, the act also has the effect of removing it from situations where it went too far. The act further limits the reach of the 2002 act by exempting small LLCs. These changes are retroactive to 2003.

The concept of control is determined by tracing ownership of the capital interests in the LLC's assets. A capital interest is the right to receive some or all of the assets under the LLC's governing law if the LLC were dissolved. Ownership of the capital interests in an LLC is traced, using the principles of constructive ownership, through any noncorporate entities. The chain of constructive ownership can run through layers of noncorporate entities but not through individuals. The franchise tax is payable by the corporation or affiliated group of corporations to which ownership of the capital interests is traced.

Ownership of capital interests in an LLC is determined as of the last day of the LLC's tax year. If an LLC and a corporation engage in a pattern of trading assets back and forth so that neither owns them on its respective trigger date, the determination must be made as of the last day of the corporation's tax year.

If the capital interests in an LLC are owned by an affiliated group of corporations, the value of the assets is allocated among the members of the group for franchise tax purposes so that there will not be double taxation of any assets. The allocation is in proportion to each affiliate's ownership interest.

The act exempts from the attribution rules those LLCs whose total assets do not exceed $150,000. Under the laws governing business entities, an LLC pays an annual report fee of $200 while corporations pay an annual report fee of $20. The approximate threshold at which there would be no tax advantage from transferring corporate assets to an LLC is $130,000.

The act also makes a number of other changes to the law. It reduces the threshold percentage of an LLC's assets that a corporation must control before the franchise tax is triggered. The current threshold is 70% or more but applies to a much broader realm of parties through whom ownership may be attributed. This act sets the threshold percentage at more than 50% beginning in 2005. The act also corrects the formula for tracing ownership to remove the 2002 law's potential effect of attributing 100% of an LLC's assets when the corporation controls less than 100%. Finally, the act removes membership in the LLC as an additional condition for attribution. That condition created a loophole and served no purpose.

REDUCE PRIVILEGE AND EXCISE TAXES.

Session Law	*Bill #*	*Sponsor*
S.L. 2004-84	**HB 1303**	**Representative Starnes**

AN ACT TO REDUCE PRIVILEGE AND EXCISE TAXES.

OVERVIEW: This act reduces certain privilege and excise taxes as follows:

- It exempts two additional types of activities from the 3% privilege tax on amusements:
    - A youth athletic contest with an admission price that does not exceed $10, with participating athletes younger than 20 years of age, and that is sponsored by a person exempt from income tax.

- All exhibitions, performances, and entertainments promoted and managed by a nonprofit arts organization that is exempt from income tax.

- It reduces the excise tax on cigarettes, other tobacco products, wine, beer, and spirituous liquor by allowing a 2% discount on the tax due.

FISCAL IMPACT: No exact fiscal estimate is possible with regard to the privilege license tax exemptions because the Department of Revenue cannot estimate how many organizations would be affected and is not certain that all potentially affected organizations have been paying the tax owed. The 2% excise tax discount results in a loss to the General Fund of $760,000 from tobacco products and $1.8 million from alcoholic beverages for fiscal year 2004-2005. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2004 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The section regarding the privilege license tax exemptions for certain amusements became effective July 1, 2004. The section allowing the excise tax discounts became effective for reporting periods beginning on or after August 1, 2004. The act was signed into law by the Governor on July 8, 2004.

ANALYSIS:

Privilege Tax Exemptions

The State levies a privilege tax at the rate of 3% on the gross receipts derived from amusements that a person gives, offers, or manages unless the amusement is exempted by statute.[18] G.S. 105-40 exempts several forms of amusements from the privilege tax, including local talent shows, elementary and secondary school athletic contests and dances, and certain arts and community festivals.

The act creates two new exemptions from the amusements tax. First, the act exempts a youth athletic contest with an admission price that does not exceed $10 and that is sponsored by a person exempt from income tax. Each participating athlete must be younger than 20 years of age. Second, the act exempts all exhibitions, performances, and entertainments promoted and managed by a nonprofit arts organization that is exempt from corporate income tax.. This exemption does not apply to athletic contests, but applies regardless of where the amusement is held, the amount of compensation paid to provide the amusement, or the amount of the receipts derived from the amusement. The amusement tax exemptions became effective July 1, 2004.

Excise Tax Reductions

Before August 1, 2003, distributors and wholesalers who timely paid the excise taxes on cigarettes, other tobacco products, wine, beer, and liquor were eligible for a discount equal to 4% of the tax due. In 2003, the General Assembly eliminated these discounts (S.L. 2003-284). This act reinstates the discounts, but at a rate of 2% of the tax due. The cigarette and tobacco discounts are intended to cover expenses incurred in preparing tax reports and the expense of furnishing a bond. The discounts for alcoholic beverages are intended to cover these expenses

[18] The amusement tax was originally intended to piggyback the sales tax. The law taxed entertainment "at the rate of tax levied" by the sales tax statutes. In 1989, when the sales tax rate was 3%, the piggyback language was changed to a stated 3% rate. When the sales tax was increased from 3% to 4%, the amusement tax should have been increased as well, but due to oversight, the change was not made.

and also losses due to spoilage or breakage. The discounts became effective for reporting periods beginning on or after August 1, 2004.

EMERGENCY FUNDING/CONTINUING PROVISIONS.

Session Law	*Bill #*	*Sponsor*
S.L. 2004-88	**HB 1352**	**Representative Owens**

AN ACT TO PROVIDE EMERGENCY FUNDING FOR THE ONE NORTH CAROLINA FUND AND THE NEW AND EXPANDING INDUSTRY TRAINING PROGRAM, TO CODIFY PROVISIONS RELATED TO THE ONE NORTH CAROLINA FUND, TO APPROPRIATE FUNDS TO THE RURAL ECONOMIC DEVELOPMENT CENTER TO BE USED FOR ECONOMIC INFRASTRUCTURE, AND TO MAKE NECESSARY TRANSITIONAL ADJUSTMENTS TO THE STATE BUDGET.

OVERVIEW: The act establishes funding programs and makes appropriations as follows:

- Establishes the One North Carolina Fund as a special reserve fund, codifies the provisions related to the Fund, and appropriates $20 million to the Fund for the 2003-2004 fiscal year.
- Appropriates $4.1 million to the Community Colleges System for the 2003-2004 fiscal year for new and expanding industry training.
- Appropriates $20 million to the Rural Economic Development Center for the 2003-2004 fiscal year to:
    - Establish the North Carolina Infrastructure Program.
    - Provide matching grants to local governments in distressed areas and equity investments in public-private ventures that will reuse vacant buildings.
    - Provide research and demonstration grants.
- Appropriates $20 million to the Teachers' and State Employees' Retirement System Fund in the 2003-2004 fiscal year to partially pay back the debt owed to the Fund.

The remainder of the act sets out temporary year-end transitional provisions that were in effect until the passage of The Current Operations and Capital Improvements Appropriations Act of 2004.

FISCAL IMPACT: There are no finance provisions in this act. The appropriations in the act reduced the 2003-2004 end-of-year General Fund balance because they were made for the 2003-2004 fiscal year. Due to the late passage of the act, the appropriated moneys will be expended beginning in the 2004-2005 fiscal year. See the Analysis for further explanation of these appropriations.

EFFECTIVE DATE: The sections of the act dealing with the One North Carolina Fund, the New and Expanding Industry Training Program, the Rural Economic Center, and the Teachers' and State Employees' Retirement System Fund became effective June 30, 2004.

ANALYSIS:

One North Carolina Fund

Section 1 of the act appropriates $20 million in non-reverting funds to the One North Carolina Fund for the 2003-2004 fiscal year. The Department of Commerce may use up to $300,000 of this appropriation for administering the Fund and other economic development incentive grant programs during the 2004-2005 fiscal year. The act also expresses the intent of the General Assembly that there be an annual recurring appropriation of $10 million beginning in the 2006-2007 fiscal year. The codification of and appropriation to the One North Carolina Fund were proposed by the Joint Select committee on Economic Growth and Development, except that the Committee proposed appropriating $10 million to the Fund for the 2004 2005 fiscal year.[19]

The One North Carolina Fund was created in 1993 and was originally known as the Industrial Recruitment Competitive Fund. The Fund was established in order to provide a source of funding to be used by the Governor and the Department of Commerce in recruiting or retaining new and expanding businesses. Moneys in the Fund may be used only for the following purposes:

1. Installation or purchase of equipment.
2. Structural repairs, improvements, or renovations to existing building to be used for expansion.
3. Construction of or improvements to new or existing water, sewer, gas, or electric utility distribution lines or equipment for existing buildings.
4. Construction of or improvements to new or existing water, sewer, gas, or electric utility distribution lines or equipment for new or proposed buildings to be used for manufacturing and industrial operations.
5. Any other purposes specifically provided for by an act of the General Assembly.

Appropriations to the Fund have been sporadic since its inception in 1993. The Fund received a $5 million appropriation in 1993-1994 and a $7 million appropriation in 1994-1995. Over the next six fiscal years, the Fund received an appropriation of either $1 million or $2 million each year. For the 2001-2002 fiscal year, the General Assembly appropriated $15 million to the Fund. No appropriations to the Fund were made in the 2002-2003 or 2003-2004 fiscal years. Although the Fund was never set up as a non-reverting account, each year the General Assembly allowed the moneys remaining in the Fund to be carried over to the next fiscal year.

Moneys from the Fund are allocated only to local governments for use in connection with securing commitments for the recruitment, expansion, or retention of new and existing businesses. Over the years, the Department of Commerce has developed a set of guidelines relating to disbursements from the Fund. These guidelines include the following:

- Any disbursement of State funds must be matched by a local contribution. The local contribution can take the form of cash, fee waivers, in-kind services, donation of assets, provision of infrastructure, or a combination of these.
- Grants are made from the Fund only as certain performance goals are met, generally in four installments.

[19] The Joint Select Committee on Economic Growth and Development is an interim committee consisting of 28 members appointed by the President Pro Tempore of the Senate and the Speakers of the House of Representatives. The Committee issued a report to the 2003 General Assembly and is to terminate upon the convening of the 2005 General Assembly.

- Funds are disbursed only in accordance with two separate agreements: a company performance agreement entered into by the grantee business and the local government and a local government grant agreement entered into by the Department of Commerce and the local government.
- Receipt of a grant under the Fund generally requires job creation, but may be based on retention of existing jobs.
- Generally, jobs that are to be created or retained must meet the William S. Lee Act wage standard and provide health insurance.

The act codifies the One North Carolina Fund in the General Statutes as a special revenue fund in the Department of Commerce. Special revenue funds are non-reverting funds that are tracked differently for budgetary purposes. The act further codifies the purposes of the Fund as well as the existing guidelines regarding local match, job creation or retention, written agreements, disbursement only following performance, and purposes for which grants may be made. The wage standard and health insurance guidelines were not codified.

The act also provides that the Department of Commerce and the Governor's Office will develop program guidelines for the funds, as was done under prior law, and provides an exemption from the Administrative Procedure Act's rulemaking procedures in developing these guidelines. Guidelines that are in effect for the Fund when this act became law will continue in effect until the new guidelines are adopted.

The Department of Commerce must publish a report at the end of each fiscal quarter providing information on the commitment, disbursement, and use of funds allocated under the Fund. This report must be submitted to the Joint Legislative Commission on Governmental Operations, the House of Representatives and Senate Finance Committees and Appropriations Committees, and the Fiscal Research Division of the General Assembly.

New and Expanding Industry Training Program

Section 1 of the act appropriates $4.1 million in non-reverting funds to the Community Colleges System Office for the 2003-2004 fiscal year for new and expanding industry training. The New and Expanding Industry Training (NEIT) Program, started in 1958, supports the economic development efforts of the State by providing education and training opportunities for new and expanding businesses. Companies creating 12 or more production jobs in excess of their previous 3-year maximum employment level are eligible for assistance through the NEIT Program.

Rural Economic Development Center

Section 2 of the act appropriates $20 million to the Rural Economic Development Center for the 2003-2004 fiscal year to be allocated as follows:

- To establish the North Carolina Infrastructure Program. This Program will provide grants to local governments to construct critical water and wastewater facilities and to provide other infrastructure needs, including technology needs, to sites where these facilities will generate private job-creating investment. At least $15 million of the appropriated funds must be used to provide these grants. The Center must make annual reports of the Program's progress to the Joint Legislative Commission on Governmental Operations. The initial report is due no later than January 15, 2005. The Joint Select Committee on Economic Growth and Development had proposed that $15 million be appropriated to

the Center to establish the North Carolina Infrastructure Program for the 2004-2005 fiscal year.

- To provide matching grants to local governments in distressed areas and equity investments in public-private ventures that will productively reuse vacant buildings, with priority given to towns with a population of less than 5,000.
- To provide research and demonstration grants.

Teachers' and State Employees' Retirement System Fund

Section 3 of the act appropriates $20 million to the Teachers' and State Employees' Retirement System Fund for the 2003-2004 fiscal year to partially pay back the debt owed to this Fund. In the 2000-2001 fiscal year, the Governor took $130 million from this Fund to help cover the budget shortfall.

The remaining sections of the act make necessary transitional adjustments to the State Budget pending the passage of The Current Operations and Capital Improvements Appropriations Act of 2004.

IRC UPDATE AND OTHER TAX CHANGES.

Session Law	*Bill #*	*Sponsor*
S.L. 2004-110	**HB 1430**	**Representative Miner**

AN ACT TO UPDATE THE REFERENCE TO THE INTERNAL REVENUE CODE USED IN DEFINING AND DETERMINING CERTAIN STATE TAX PROVISIONS, TO SET THE PUBLIC UTILITY AND INSURANCE REGULATORY FEES, TO EXTEND THE SUNSET ON THE LOW-INCOME HOUSING TAX CREDIT, TO CLARIFY THE SALES TAX INCENTIVES FOR MAJOR PROJECTS, TO MAINTAIN THE CURRENT SALES TAX RATES ON ELECTRICITY USED BY MANUFACTURERS, AND TO ESTABLISH FAMILY COURT FEES.

OVERVIEW, EFFECTIVE DATES, AND FISCAL IMPACT:

Part	*Description and Effective Dates*	*General Fund Impact*
1	**IRC Update** Changes the reference date to the Internal Revenue Code from June 1, 2003, to May 1, 2004. This part became effective when signed into law by the Governor on July 17, 2004. However, any amendments to the Internal Revenue Code enacted after June 1, 2003 that would have increased North Carolina taxable income for the 2003 taxable year are effective beginning with the 2004 taxable year.	**Military Family Tax Relief Act of 2003** $1.2 million loss in 2004-2005 700,000 annual loss thereafter **Medicare Prescription Drug, Improvement, and Modernization Act of 2003** $1.4 million loss in 2004-2005 $4.3 million loss in 2005-2006 **Pension Funding Equity Act of 2004** No Revenue Estimate Available

Part	Description and Effective Dates	General Fund Impact
2	**Regulatory Fee for Utilities Commission** Sets the electric membership corporation regulatory fee at $200,000 and the percentage to be used in calculating the public utility regulatory fee at 0.12%. This part became effective July 1, 2004	$12.6 million gain in 2004-2005
3	**Insurance Regulatory Charge** Sets the percentage to be used in calculating the insurance regulatory charge at 5%. This part is effective for the 2004 calendar year.	$24.1 million gain in 2004-2005
4	**Extend Low-Income Housing Credit Sunset** Extends the Low-Income Housing Tax Credit Program from 2006 to 2010. This part became effective when signed into law by the Governor on July 17, 2004.	$18.6 million loss in 2007-2008 $37.5 million loss in 2008-2009 $38.7 million loss in 2009-2010 $40.4 million loss in 2010-2011 $20.7 million loss in 2011-2012
5	**Sales Tax Clarification** Clarifies that the sales tax refund for purchase of building materials on certain industrial projects applies only to materials purchased for initial construction. This part became effective July 1, 2004.	No fiscal impact.
6	**Maintain Current Sales Tax Rates on Electricity Used by Manufacturers** Repeals the graduated sales tax rate on electricity used by manufacturers and enacts a lower rate for electricity used in an aluminum smelting facility. This part becomes effective October 1, 2004.	**Repealing Graduated Rate** $9.6 million gain beginning with the 2005-2006 fiscal year. **Lower Rate for Aluminum Smelting Facilities** No estimate available, possible annual losses of $800,000.
7	**Family Court Fees** Allows the Administrative Office of the Courts to establish a fee of up to $30 for the use of supervised custody/exchange centers. This part became effective when signed into law by the Governor on July 17, 2004.	No estimate available

(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2004 Session. Available in the Legislative Library.)

ANALYSIS:

Part 1: IRC Update

North Carolina's tax law tracks many provisions of the federal Internal Revenue Code, by reference to the Code.[20] The General Assembly determines each year whether to update its reference to the Internal Revenue Code.[21] 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. Under North Carolina law prior to the enactment of this act, the reference date to the Code was June 1, 2003. Part 1 of this act changes the reference date to May 1, 2004. Changing the reference date to May 1, 2004, incorporates federal changes made in the three following acts: the Military Family Tax Relief Act of 2003 (P.L. 108-121), the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (P.L. 108-173), and the Pension Funding Equity Act of 2004 (P.L. 108-218).

Military Family Tax Relief Act of 2003 (MFTRA), (P.L. 108-121). – The Military Family Tax Relief Act of 2003 made numerous changes to federal tax laws. These changes include the following:[22]

- Adoption of special rules regarding the exclusion of gain on sale of a principal residence by a member of the uniformed services or the Foreign Service, effective for sales occurring on or after May 6, 1997.[23]
- Exclusion from gross income of certain death gratuity payments.
- Exclusion from gross income of amounts received under the Department of Defense Homeowners Assistance Program
- Expansion of combat zone filing rules to contingency operations.
- Modification of veterans' organizations' membership requirements for tax-exempt status.
- Exclusion from gross income of Dependent Care Assistance Program payments to members of the uniformed services.
- Suspension of tax-exempt status of terrorist organizations.

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[20] 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.

[21] 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."

[22] A more detailed analysis of these provisions may be obtained from *Technical Explanation of H.R. 3365, The "Military Family Tax Relief Act of 2003," as Passed by the House of Representatives and the Senate*, Joint Committee on Taxation, November 7, 2003, JCX-99-03.

[23] The federal legislation provided a one-year period for taxpayers to file an amended return that would otherwise have been barred by the statute of limitations. That one-year period will end on November 11, 2004. This act allows a taxpayer an exception to the State statute of limitations as long as the taxpayer files the claim by the same date, November 11, 2004.

- Above-the-line deduction of overnight travel expenses of National Guard and Reserve members.
- Extension of certain tax relief provisions to astronauts.

Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (P.L. 108-173). – The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (P.L. 108-173) contained one significant tax provision. As part of that law, Congress created Health Savings Accounts (HSAs). The federal legislation allows a person to accumulate funds on a tax-preferred basis to pay for certain medical expenses. An employer, an eligible individual, or both may make contributions to the account. The earnings in the account grow tax-free. Employer contributions to an HSA are excludable from gross income and contributions by an eligible individual are deductible in computing adjusted gross income.

Distributions from an HSA for medical expenses are excludable from income, except for amounts distributed to pay most health insurance premiums. However, tax-free distributions from an HSA may be used to pay the following health insurance premiums: retiree health insurance premiums for individuals who have reached Medicare eligibility; premiums for COBRA coverage; premiums for qualified long-term care insurance contracts; and premiums for a health plan during a period in which an individual is receiving unemployment. Distributions from an HSA for non-medical expenses are includible in gross income.

Pension Funding Equity Act of 2004 (P.L. 108-218). – The Pension Funding Equity Act of 2004, signed by the President on April 10, 2004, made changes to the Internal Revenue Code and the Employee Retirement Income Security Act (ERISA). The federal legislation allows employers (both pension plan sponsors across the board as well as those in specifically targeted industries) to lower the amount of both their pension contributions and premiums paid to the Pension Benefit Guaranty Corporation (PBGC). By lowering the amount of required payments to pension plans and to the PBGC, the federal legislation could result in higher taxable income for the affected companies. The PBGC is the government agency that insures certain underfunded benefits in defined benefit plans. Underfunded single employer defined benefit plans, those plans that do not have sufficient assets to pay benefits if the plan were to terminate, provide the greatest risk to the PBGC. Sponsors of plans that are considered underfunded must make contributions to their plans in addition to paying variable-rate premiums to the PBGC based on the amount of underfunding. Pension plan benefits promised to employees remain the same. The federal legislation specifically provides the following temporary relief for many pension plans:

- For years 2004 and 2005, the federal legislation replaces the 30-year Treasury bond rate used to calculate employer's pension contributions and premiums paid to the PBGC with a long-term corporate bond rate. The 30–year Treasury bond, last issued in 2001, has had an historically low interest rate. A lower interest rate requires pension plans to make higher contributions because they are assuming a lower rate of return. The new rate is based on the four-year weighted average of high quality bond yields. Plans with funded current liabilities of less than 100% must estimate quarterly payments for the plan year. Failure to make required payments subjects the employer to excise taxes. If a plan's assets are not sufficient to cover at least 90% of its current liability, it is subject to additional funding requirements. The federal legislation will allow more plans to meet the 90%-funded threshold and avoid additional contributions.
- The federal legislation provides deficit reduction contribution (DRC) relief to under-funded plans in the airline and steel industries and to the Transportation Communications Union plan. The DRC is a payment required from pension plans that are

significantly underfunded. Plans that are less than 90% funded on a current liability basis generally are subject to an additional minimum funding requirement. A DRC payment is required in addition to the pension plan sponsor's normal annual contribution. The federal legislation allows plan sponsors that would normally be subject to DRC liability to reduce their payments by 80% for two years. During the two years of DRC relief, plan sponsors are precluded from increasing benefits for those two years except for benefit increases required by collective bargaining agreements and increases that will be paid for by increased contributions. Plan sponsors are required to notify plan participants that the sponsor has taken DRC relief within 30 days of filing that election, thereby putting the employees on notice that the plan sponsor is not fully funding the plan. Any plan that takes DRC relief must also report to the PBGC the amount of DRC contributions the sponsor was spared, how long it would take the company to become fully funded if only regular, required contributions were made, and how the amount by which the plan is underfunded compares with the capitalization of the company.

In addition, the federal legislation allows an eligible multi-employer plan to elect to defer amortization of up to 80% of the 2002 net experience losses for two plan years. Under previous law, if a multi-employer plan had a net experience loss for a plan year, the plan's funding standard account was charged with the amount needed to amortize the net experience loss over 15 years. The federal legislation defers funding of 80% of the 2002 actuarial loss for up to two years. It is expected that very few of the 1,600 plus multi-employer plans will meet the eligibility requirements for this relief.[24] If the eligible plan elects to defer charges attributable to its 2002 net experience loss, the plan must provide written notice of the election within 30 days to participants and beneficiaries, to each labor organization representing participants and beneficiaries, to each employer that has an obligation to contribute under the plan, and to the PBGC.

Part 2: Regulatory Fee for Utilities Commission

Part 2 of this act sets the rate for the public utility regulatory fee for the 2004-2005 fiscal year at 0.12%. The rate for 2003-2004 was the same. The rate for this fee must be set each year by the General Assembly. The utility regulatory fee is a tax that was first imposed in 1989. The proceeds of the fee are credited to the Utilities Commission and Public Staff Fund and used to defray the State's cost in regulating public utilities. The regulatory fee is imposed on all utilities that are subject to regulation by the North Carolina Utilities Commission. The fee is a percentage of the utility's North Carolina jurisdictional revenues. In general, jurisdictional revenue is derived from providing utility service in North Carolina.

In addition to funding the State's cost in regulating public utilities, the money in the Utilities Commission and Public Staff Fund is currently used to finance the work of the Study Commission on the Future of Electric Service in North Carolina. The General Assembly established the Commission in 1997 to examine the cost, adequacy, availability, and pricing of electric service in North Carolina to determine whether legislation is necessary to assure an adequate and reliable source of electricity and economical, fair, and equitable rates for all consumers of electricity in North Carolina. Section 14.10 of S.L. 2000-67, the Current Operations and Capital

[24] Eligible multi-employer plans are those that experienced an investment loss of at least 10% of assets in the plan year beginning in 2002 and for which the negotiated contributions are expected to be insufficient to satisfy minimum funding requirements in a plan year beginning after June 30, 2003 and before July 1, 2006. Multi-employer plans are not subject to the DRC. Instead, employers paying into a multi-employer plan are subject to excise taxes if the multi-employer plan is not fully funded.

Improvements Appropriations Act of 2000, extended the life of the Study Commission and its funding from the Utilities Commission and Public Staff Fund through June 30, 2006.

Part 2 of this act also sets at $200,000 for the 2004-2005 fiscal year the annual public utility regulatory fee imposed on electric membership corporations whose principal purpose is to furnish or cause to be furnished bulk electric supplies at wholesale. The new rate is the same as the rate in effect for the preceding three fiscal years. The proceeds of the fee are credited to the Utilities Commission and Public Staff Fund and used to defray the State's cost in regulating electric membership corporations.

The 1999 General Assembly enacted S.L. 1999-180, which authorized electric membership corporations to form subsidiary corporations that may provide energy services and products, telecommunications services and products, and water and wastewater collection and treatment. The subsidiary must fully compensate the electric membership corporation for its use of the corporation's personnel, services, equipment, and property. The Utilities Commission is charged with regulating this aspect of the subsidiary's business and, to pay for this regulation, S.L. 1999-180 levied a flat-rate regulatory fee to be paid annually by the North Carolina Electric Membership Corporation. The General Assembly must establish the fee amount each year. The North Carolina Electric Membership Corporation is the only electric membership corporation whose principal purpose is to furnish or cause to be furnished bulk electric supplies at wholesale as provided in G.S. 117-16. It is a "generation and supply cooperative" owned by its members. Its members are all but one of the existing North Carolina electric membership corporations, which are "distribution cooperatives." Thus, the fee imposed on the North Carolina Electric Membership Cooperation will be passed on to its member electric membership corporations.

Part 3: Insurance Regulatory Charge

Part 3 of this act sets the insurance regulatory charge at 5% for the 2004 calendar year, the same as the rate set for the 2003 calendar year. The insurance regulatory charge was first enacted in 1991 to defray the State's cost of regulating the insurance industry. The charge is a percentage of each insurance company's gross premiums tax liability. The insurance regulatory charge is imposed on insurance companies that pay the gross premiums tax and, beginning in 2000, on health maintenance organizations and medical service corporations. Insurance companies and medical service corporations pay a 1.9% gross premium tax rate.[25] For health maintenance organizations, the charge is levied on each organization's hypothetical gross premiums tax liability determined at the 1.9% gross premiums tax rate applied to its premiums base. The hypothetical calculation is necessary because health maintenance organizations pay premiums tax at the lower rate of 1%.

Part 4: Extend Low-Income Housing Credit Sunset

Part 4 of this act extends the sunset on the low-income housing tax credit from January 1, 2006, until January 1, 2010. Developers of low-income housing begin their work months in advance and need to know what financing will be available as they secure options on sites. This act also makes a technical correction to the credit by replacing the term 'eligible basis' with the term 'qualified basis'.

Congress enacted the federal Low Income Housing Tax Credit in 1986 to fund housing for low- and moderate-income households. Each state receives a limited amount of credit each year. The Internal Revenue Service (IRS) allocates the per capita low-income housing tax credit to

[25] The premium tax rate for medical service corporations was increased from 1% to 1.9%, effective January 1, 2004. (S.L. 2003-284)

state housing agencies such as the North Carolina Housing Financing Agency (HFA), which in turn allocate the credit to project developers who agree to lower project rents for low-income tenants.

In 1999, North Carolina authorized a State income tax credit modeled after the federal housing credit. To benefit from the credit, a project developer had to sell the tax credits to receive funds to finance the project; developers indicated that the State tax credit sold for no more than 45 cents on the dollar. In 2002, the General Assembly changed the State credit so that a taxpayer may elect to receive the credit in the form of either a credit against tax liability or a loan generated by transferring the credit to the HFA in return for a 0% interest 30-year balloon loan equal to the credit amount.[26] Neither a tax refund generated by the credit nor a loan received as a result of the transfer of the credit is considered taxable income by the State. Although a State tax refund would be considered taxable income by the IRS if the taxpayer itemizes deductions, a private letter ruling from the IRS provides that the loan proceeds would not.

The purpose of the 2002 changes was to promote efficiency and cost savings. The modified credit eliminated the need to sell the credit and ensured that each State dollar dedicated for low-income housing is used to develop that housing. It is saving the State revenue over a five-year period while maintaining the same level of investment in low-income housing developments.[27] The innovative approach adopted by the General Assembly in 2002 has received a national award. The HFA found that in 2003 the percentage of federal credits used to develop projects in rural counties rose from about 25% to about 50% and it found that all urban projects have some units affordable to families below 30% of the median income for the area. The HFA also notes that the federal credits have become attractive to more purchasers since the buyer does not need to also purchase a state credit. The resulting higher prices for federal credits increase the amount affordable housing for North Carolina.

Part 5: Sales Tax Clarification

During the 2nd Extra Session of 2003[28] the General Assembly created an annual refund of State and local sales taxes paid on construction materials and fixtures for facilities that involve the investment of more than $100 million by the taxpayer and are primarily used for either of the following two industries:

- Bioprocessing
- Pharmaceutical and Medicine Manufacturing and the Distribution of Pharmaceuticals and Medicines.

The refund became effective for sales taxes paid on or after January 1, 2004. The taxpayer must apply for the refund within six months after the end of the State's fiscal year. If, after obtaining a refund, the taxpayer does not end up investing the required amount, the taxpayer forfeits the refund.

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[26] Owners of all but one of the 51 rental developments awarded federal credits in 2003 elected to use the State credit as part of their funding. All 50 project developers chose the loan option.

[27] From 2000 to 2002, the State housing credit leveraged $420 million of rental development. A total of 120 projects with 5,900 units were awarded $140 million of State housing credits for an average of $24,000 per unit in State investment. In 2003, the credit leveraged $197 million of rental development. A total of 49 projects with 2,336 units were awarded $33.2 million of State housing credit for an average of $14,200 per unit of State investment.

[28] S.L. 2003-435.

Part 5 of this act clarifies that the sales tax refund is allowed only for materials and fixtures purchased during the initial construction of the facility and not for purchases made for subsequent repairs, renovation, or equipment replacement.

Part 6: Maintain Current Sales Tax on Electricity Used by Manufacturers

Generally, electricity that is sold to a manufacturer for use at a manufacturing facility and is separately metered or measured is subject to the sales and use tax at a rate of 2.83%. Most other sales of electricity are taxed at the rate of 3%. In 2001, the General Assembly reduced to 0.17% the sales tax rate on electricity sold to manufacturers that use more than 900,000 megawatt-hours of electricity annually, effective January 1, 2002.[29] As part of the 2001 legislation, the General Assembly also established a rate schedule that would reduce the sales tax on electricity sold to manufacturers who use more than 5,000 megawatt-hours annually but less than 900,000, effective July 1, 2005.[30]

Part 6 of this act repeals the 2001 legislation, effective October 1, 2004. The taxation of electricity used by manufacturers will remain at the rate of 2.83%. At the time this act was enacted, there were no manufacturers in the State that used a volume of electricity annually to qualify for the 0.17% rate.[31] This part also provides that electricity sold to an aluminum smelting facility for use in connection with the operation of that facility and measured by a separate meter or measuring device would be taxable at 0.17%. The provision establishing the lower rate for an aluminum smelting facility sunsets for sales made on or after October 1, 2007. At this time this act was enacted, the State did not have an aluminum smelting facility. Aluminum smelting facilities use a high volume of electricity and would have been eligible for the former 0.17% rate repealed by this part. Thus, the retention of a lower sales tax rate for an additional three years encourages the operation of such a facility in North Carolina.

Part 7: Family Court Fees

Part 7 of this act authorizes the Administrative Office of the Courts (AOC) to charge a fee to persons receiving services of a supervised visitation and exchange center through a family court program. These centers provide a safe pick-up and drop-off place for custody exchanges between estranged parents. There are only a few of these centers in North Carolina. Before the enactment of this act, the programs were funded by federal Violence Against Women Act funds. With that funding, the centers were able to serve only families with a history of domestic violence. This act will allow some centers to broaden their reach to serve other clients involved with custody issues.

The fee may not exceed $30 per hour and the Director of the AOC may establish a procedure for a person to apply for a reduction in the fee, based upon the person's ability to pay as a result of indigence, status as a victim of domestic violence, or other circumstances. The fee revenue will be used to support the continued operation of these centers. The use of the services is permissive.

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[29] S.L. 2001-476, as amended by S.L. 2001-487

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Megawatt-hours used annually	Rate
5,000 or less	2.83%
Over 5,000 and up to 250,000	2.25%
Over 250,000 and up to 900,000	2.0%
Over 900,000	.17%

[31] The only manufacturer that used this volume of electricity at the time the General Assembly changed the law in 2001 was the aluminum manufacturer, Alcoa.

2004 APPROPRIATIONS ACT.

Session Law	*Bill #*	*Sponsor*
S.L. 2004-124	**HB 1414**	**Rep. Sherrill, Crawford**

AN ACT TO MODIFY THE CURRENT OPERATIONS AND CAPITAL APPROPRIATIONS ACT OF 2003 AND TO MAKE OTHER CHANGES IN THE BUDGET OPERATIONS OF THE STATE.

OVERVIEW, EFFECTIVE DATES, AND FISCAL IMPACT:

Part	*Description and Effective Dates*	*Fiscal Impact*
32B	**Sales Tax Refunds and Exemptions**	
	Refunds – Expands the refund of State and local sales and use taxes paid on construction materials and fixtures for certain industrial facilities in three ways: • Reduces from $100 million to $50 million the required investment amount for refund eligibility if the facility is located in a tier one, two, or three area, effective January 1, 2004. • Expands the list of eligible industries to include manufacturing of aircraft, computers, motor vehicles, and semiconductors, effective July 1, 2004, until July 1, 2009. • Clarifies what items are eligible for the sales and use tax refund, effective October 1, 2004.	**Refunds** – The expansion of this refund will reduce General Fund revenues by $2.4 million in FY 2004-05 and by $4.6 in FY 2005-06. **Exemptions** -
	Exemptions – Exempts the following items from the sales and use tax. Except as otherwise noted, each exemption is effective October 1, 2004. (1) Tangible personal property sold to interstate air business that becomes component part or is dispensed into commercial aircraft. (2) Plastic mulch and plant bed covers sold to a farmer for agricultural purposes. (3) Delivery charges for direct mail. (4) Sales to a professional land surveyor of tangible personal property on which custom aerial data is stored.	(1) FY 2004-05: -$2 million FY 2005-06: -$2.7 million (2) FY 2004-05: -$400,000 FY 2005-06: -$500,000 (3) FY 2004-05: -$300,000 FY 2005-06: -$400,000 (4) FY 2004-05: -$100,000 FY 2005-06: -$100,000 (5) FY 2005-06: -$4.6 million The total loss to the General Fund for these sales tax refunds and exemptions will be $4.7 million in

Part	Description and Effective Dates	Fiscal Impact
	(5) Free distribution periodicals, effective July 1, 2005.	FY 2004-05 and $7.4 million in FY 2005-06.
32C	**Qualified Business Investment Credit** Increases from $6 to $7 million the total amount of all qualified business investment credits that may be taken each year and extends the sunset on the credit from 2007 to 2008. Effective for investments made on or after January 1, 2004.	There is no fiscal impact in FY 2004-05, but the change will reduce General Fund revenues by $1 million in FY 2005-06.
32D	**Research and Development Tax Credit** Creates a new research and development tax credit as an alternative to the Bill Lee R&D credit. Effective May 1, 2005 and sunsets in 2009.	This new credit will reduce General Fund revenues as follows: FY 2004-05: $4.5 million FY 2005-06: $18.5 million FY 2006-07: $22 million FY 2007-08: $23.4 million FY 2008-09: $24.7 million
32F	**Insurable Interest of Charitable Organizations** Deems certain entities that are formed, in part, for the purpose of generating funds for charitable organizations to have an insurable interest in an individual's life and allows those entities to invest in pools of life insurance, as long as at least part of the proceeds is directed to charitable organizations. Effective July 20, 2004 and sunsets October 1, 2007.	No fiscal information available.
32G	**Job Development Investment Grant Program** • Extends from 2005 to 2006 the sunset of the Job Development Investment Grant (JDIG) Program. • Increases from 15 to 25 the number of agreements that the Economic Investment Committee (EIC) may enter into each year, effective July 20, 2004. • Increases from $10 million to $15 million the maximum annual	The expected reduction in General Fund revenues is $500,000 for FY 2004-05 and approximately $20 million in FY 2005-06.

Part	Description and Effective Dates	Fiscal Impact
	availability that the EIC may commit under the program, effective January 1, 2004. • Makes various administrative changes such as clarifying that the JDIG agreements are binding, changing the date and required contents of annual reports, and requiring that agreements include a provision encouraging the use of small businesses headquartered in North Carolina. Except for the clarification that the agreements are binding, which is retroactive to October 1, 2002, these changes became effective July 20, 2004.	

(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2004 Session. Available in the Legislative Library.)

ANALYSIS:

Part 32B: Sales Tax Refunds and Exemptions

During the 2003 2nd Extra Session, the General Assembly created an annual refund of State and local sales taxes paid on construction materials and fixtures for facilities that involve the investment of more than $100 million by the taxpayer and are primarily used for either of the following two industries:

- Bioprocessing
- Pharmaceutical and Medicine Manufacturing and the Distribution of Pharmaceuticals and Medicines.

The taxpayer must apply for the sales tax refund within six months after the end of the State's fiscal year. The refund became effective for sales taxes paid on or after January 1, 2004. If, after obtaining a refund, the taxpayer does not end up investing the required amount, the taxpayer forfeits the refund.

Section 32B.1 of this act expands that refund in three ways. First, if the facility is located in an enterprise tier one, two, or three area, a taxpayer is eligible for the refund if the taxpayer had an investment of at least $50 million in the facility rather than $100 million as was required under the 2003 law. This change is effective for sales occurring on or after January 1, 2004. Second, this act expands the list of eligible industries to include aircraft manufacturing, computer manufacturing, motor vehicle manufacturing, and semiconductor manufacturing, effective July 1, 2004, and sunset effective July 1, 2009. Third, the act makes some clarifying changes regarding what items are eligible for the sales tax refund, effective January 1, 2004.

Part 32B of this act also contains numerous sales and use tax exemptions. This act exempts the following things from the sales and use tax effective October 1, 2004:

- Tangible personal property that is sold to an interstate air business and becomes a component part of or is dispensed as a lubricant into commercial aircraft during its

maintenance, repair, or overhaul. This exemption supplements an existing sales tax exemption for sales of aircraft lubricants, aircraft repair parts, and aircraft accessories to an interstate air courier or a passenger air carrier for use at the courier's or carrier's hub. The new exemption is broader in that it (1) eliminates the requirement that the items be for use at a hub, (2) allows the exemption for sales to an interstate freight carrier, and (3) expands the types of property that are exempt. The new exemption is narrower in that it is limited to items related to commercial aircraft, which are large aircraft regularly used for carrying for compensation passengers, freight, or packages and letters.

- Plastic mulch and plant bed covers that are sold to a farmer for agricultural purposes.
- Delivery charges for delivery of direct mail if those charges are separately stated. Delivery charges, including postage, are taxable in North Carolina.[32] "Delivery charges" are those charges imposed by the retailer for preparation and delivery of personal property services to a location designated by the consumer. The proposed exemption is not required by the Streamlined Sales Tax Agreement for compliance, but is a permissible exemption. Before 2002, delivery charges were not taxable for in-state transactions subject to sales tax where the title to the property passed at the point of origin. Under the Streamlined Agreement, all delivery charges are included in the sales price of an item and therefore subject to tax. In order to conform to the Agreement, the General Assembly removed the sales tax exemption for delivery charges on in-state transactions, effective January 1, 2002.
- Sales to a professional land surveyor of tangible personal property on which custom aerial data is stored in digital form or is depicted in graphic form.

Section 32B.4 exempts certain free distribution periodicals from sales tax effective July 1, 2005. To qualify for the exemption, the periodical must be a publication that is published on a periodic basis at recurring intervals monthly or more frequently, is free, and is distributed in any manner other than by mail.

Under current law, supplies (paper, ink, and other tangible personal property) sold for free publications are subject to sales and use tax. Before October 1, 1999, a sales tax exemption was given for sales of paper, ink, and other tangible personal property to commercial printers and publishers for use as component parts in free circulation publications that contained advertising of a general nature. The exemption applied to general shoppers guides, but not to more specialized guides, such as real estate guides, because the statute specifically required that the free circulation publication contain advertising of a general nature. The exemption was repealed because it was believed to be unconstitutional. The first amendment of the United States Constitution generally does not allow a state to discriminate between publications based on content. A 1987 U.S. Supreme Court decision held that a similar tax provision was unconstitutional.[33]

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[32] At least one state Supreme Court has found that the United States Constitution prohibits the taxation of pass-through postage charges on catalogs and fliers mailed by a retailer (*H.J. Wilson Co. Inc. v. Mississippi State Tax Commission*). The court held that postage is an obligation of the federal government and that the state is constitutionally prohibited from taxing postage charges.

[33] In *Arkansas Writer's Project, Inc. v. Ragland*, 481 US 221, the United States Supreme Court invalidated an Arkansas sales tax scheme that taxed general interest magazines but exempted single topic printed material. The North Carolina tax exemption operated in the opposite manner: it taxed component parts used in single topic advertising publications but exempted component parts used in advertising

Part 32C: Qualified Business Investment Credit

The qualified business investment tax credit is allowed for an individual taxpayer who purchases the equity securities or subordinated debt of a qualified business venture, a qualified grantee business, or a qualified licensee business directly from that business. The credit is equal to 25% of the amount invested and may not exceed $50,000 per individual in a single taxable year. An individual investor may also claim the allocable share of credits obtained by "pass-through entities" of which the investor is an owner. Pass-through entities include limited partnerships, general partnerships, S corporations, and limited liability companies. The credit may not be taken in the year the investment is made. Instead, the credit is taken in the year following the calendar year in which the investment was made, but only if the taxpayer files an application with the Secretary of Revenue. Any unused credit may be carried forward for the next five years.

The total amount of credits allowed to all taxpayers for investments made in a calendar year may not exceed a maximum amount set in the statute. Part 32C of this act increases the maximum amount from $6 million to $7 million. The Secretary of Revenue calculates the total amount of tax credits claimed from applications filed. If the amount exceeds the maximum, then the Secretary allows a portion of the tax credits claimed by allocating the statutory maximum amount in tax credits in proportion to the size of the credit claimed by each taxpayer.

The credit was set to expire as of January 1, 2007. Part 32C of this act extends one year, until January 1, 2008.

Part 32D: Research and Development Tax Credit

Part 32D of this act creates a new research and development tax credit as an alternative to the Bill Lee research and development credit, which is set to expire along with the entire Bill Lee Act as of January 1, 2006. A taxpayer is not allowed to take both the new credit and the Bill Lee Act credit for the same activity.

The Bill Lee research and development tax credit uses the federal credit for research and development as its starting point. In order to be eligible for the research and development credit under the Bill Lee Act, a taxpayer must meet all of the general eligibility requirements of that Act. These include satisfying requirements related to employee wages, the principal activity of the establishment, the provision of health insurance, the taxpayer's Occupational Safety and Health Act record, the taxpayer's environmental record, and the absence of overdue tax debts. Under the Bill Lee Act, the research and development credit may be applied against the income tax, the franchise tax, or the gross premiums tax. The amount of credit taken in a particular year may not exceed 50% of the liability for the tax against which it is claimed and any excess may be carried forward for 15 years.

The alternative credit created in this part, which becomes effective for expenses on or after May 1, 2005, differs from the research and development credit allowed under the Bill Lee Act in the following ways:

- Bill Lee limitations on the principal activity of the establishment at which the research and development is conducted do not apply. This change will make more taxpayers eligible for the new credit for research and development expenditures than for the existing Bill Lee Act credit.

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publications that contained advertising of a general nature. Constitutionally, these distinctions appear meaningless.

- The taxpayer is not required to have no overdue tax debts. The taxpayer must still satisfy Bill Lee Act requirements related to employee wages, the principal activity of the establishment, the provision of health insurance, the taxpayer's Occupational Safety and Health Act record, and the taxpayer's environmental record.
- In the case of research and development conducted in North Carolina by a research university, the new credit is 15% of the amount the taxpayer paid to the university for the research and development.
- For other research and development, the new credit is based on North Carolina research and development expenditures rather than on an apportioned share of nationwide increases in expenditures. The rate is determined as follows:
    - For small businesses, the rate is 3%.
    - For research and development conducted in enterprise tiers one, two, or three, the rate is 3%.
    - For other research and development expenditures, the rate ranges from 1% to 3% as the amount of those expenditures increases.
- The new credit will sunset with the 2009 taxable year, rather than with the 2006 taxable year.

This part specifically sunsets the existing Bill Lee research and development credit January 1, 2006. Although the entire Bill Lee Act is set to sunset January 1, 2006, if that date is extended, this part provides that the Bill Lee Act research and development credit will nonetheless be repealed, allowing only one year of overlap with the new credit.

This part requires the Department of Revenue to make annual reports regarding the new credit to the Revenue Laws Study Committee and the Fiscal Research Division.

Part 32F: Insurable Interest of Charitable Organizations

In general, one must have an insurable interest in the life of another in order to purchase a life insurance contract on the life of that person. An "insurable interest" is a reasonable expectation of pecuniary benefit from the continued life of another. The concept of insurable interest has been developed, in part, in response to public policy concerns about wagering on the life or well-being of strangers or mere acquaintances. Under North Carolina law, an organization described in section 501(c)(3) of the Internal Revenue Code may have an insurable interest in an individual if that individual consents to the purchase or assignment of life insurance proceeds to that organization. This conclusion is supported by the argument that a charity could face a significant loss of revenue at the time of death of a key donor.

Part 32F of this act deems certain entities to have an insurable interest in an individual's life. In order to be deemed to have an insurable interest in an individual's life, an entity must satisfy all of the following conditions:

- The entity is a trust, business trust, corporation, limited liability company, or similar entity that is approved in writing by the individual as the beneficiary and owner of a life insurance policy and annuity contract on the life of the insured.
- The entity is formed for the purpose, in part, of generating funds for one or more charitable organizations described in section 501(c)(3) of the Internal Revenue Code.

- The payments to the entity under the annuity contract must be reasonably anticipated to fund the premiums on the life insurance policy beginning with the second year.
- Either each benefited charitable organization provides an affidavit to the entity stating that it has been in existence for at least three years and has at least $5 million in assets or the insured provides an affidavit to the entity stating that he or she is an accredited investor.
- The insured has provided an affidavit to the entity that neither the insured, a relative, or an entity controlled by the insured or a relative has received any monetary remuneration in connection with the consent to purchase the life insurance policy and annuity contract.
- Prior to the ownership or purchase of the life insurance policy and annuity contract, each benefited charitable organization is provided a written description of the minimum percentage or amount of the life insurance proceeds that is reasonably anticipated to be paid to the organization.

In essence, this change allows individual and institutional investors the opportunity to invest in pools of life insurance, as long as at least a portion of the proceeds is to be directed to charitable organizations. The provision will expire on October 1, 2007.

Supporters of this type of arrangement have argued that it provides a low cost, or no cost, way of directing current or future income to charitable organizations. Opponents of this type of arrangement have argued that it could pose a threat to the stability of the life insurance industry, that it is against public policy in that it promotes wagering on human life, and that the arrangement may harm individuals in that they may later be unable to obtain enough life insurance to meet their own personal needs.

Part 32G: Job Development Investment Grant Program

Part 32G of this act extends the sunset of the Job Development Investment Grant (JDIG) Program and allows the Economic Investment Committee to enter into more agreements and commit more funds under the program. It also clarifies that the JDIG agreements are binding, adds a requirement for an additional provision in each agreement, makes two technical corrections, and changes the date and required contents of annual reports.

The JDIG Program is an economic development incentive program that was created by the General Assembly in 2002. Under the program, grantee businesses are given a grant paid for a period of up to 12 years. The grant is based on a percentage of personal income tax withholdings from new positions created by the grantee business.

When the JDIG Program was created in 2002, the General Assembly put some significant limitations on the program in order to give the General Assembly time to evaluate it before a significant amount of funds had been committed. First, the General Assembly put a sunset on the ability of the Economic Investment Committee (EIC) to enter into new agreements under the program. The authority of the EIC to enter into new agreements did not begin until January 1, 2003, and was set to expire January 1, 2005. Second, the EIC could enter into no more than 15 new agreements each year. Third, the maximum annual liability for agreements entered into during any calendar year could not exceed $10 million.

Part 32G eases these three restrictions. First, the act extends the authority of the EIC to enter into new agreements by one year – until January 1, 2006. Second, the EIC is allowed to enter into a maximum of 25 new agreements a year rather than 15. Third, the cap on the maximum

annual liability from grants entered into during any particular year is increased from $10 million to $15 million. These changes became effective July 20, 2004, when the bill was signed into law by the Governor.

In addition, this part makes several administrative changes requested by the Department of Commerce. It changes the date upon which reports under the program are due from the grantee business and the requirement that the grantee business submit a copy of its State and federal returns each year. The reporting date is changed from February 1 to March 1. The grantee business is required to submit a copy of its State and federal tax returns only upon request of the EIC. The Department of Commerce has found that the federal and State tax returns provide little information that is directly relevant to the administration of the program. In addition, some grantee businesses have reported that their tax returns, particularly federal tax returns, are extremely voluminous. The Department felt that in most cases this requirement would be a burden on both the grantee business and the EIC and that it would yield little, if any, relevant information.

This part makes two technical corrections to the way employment is measured. In addition, it clarifies that commitments made under the JDIG program are binding commitments of the State and are not subject to annual appropriations.

This part requires each community economic development agreement to include a provision encouraging the business to contract with small businesses headquartered in North Carolina. The 2002 law already required agreements to contain several provisions encouraging, but not requiring, grantee businesses to act in certain ways. This provision expresses the desire of the State that the grantee businesses contract with local small businesses. This provision was a recommendation of the Joint Select Committee on Small Business Economic Development.

This part also contains language expressing the intent of the General Assembly that the EIC should give priority consideration for grants to projects located in less prosperous parts of the State. Finally, the part directs the chairs of the House and Senate Finance Committees to conduct a comprehensive, systematic study of the JDIG program and to report by April 1, 2005.

MODIFY YOUTH FACILITY DEBT AUTHORIZATION.

Session Law	*Bill #*	*Sponsor*
S.L. 2004-126	**HB 1795**	**Representative Luebke**

AN ACT TO MODIFY THE AUTHORIZATION FOR SPECIAL INDEBTEDNESS FOR YOUTH DEVELOPMENT CENTERS.

OVERVIEW: This act modifies the 2003 authorization[34] for special indebtedness for youth development centers to reflect the changes in the project's scope and reduces the amount authorized from $6,780,000 to $4,460,000.

FISCAL IMPACT: The act generates General Fund savings because it reduces the debt amount authorized in 2003 by $2,320,000. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2004 Session. Available in the Legislative Library.)*

[34] Section 46A.2 of S.L. 2003-284, the 2003 Budget Act.

EFFECTIVE DATE: The act became effective when it was signed into law by the Governor on July 22, 2004.

ANALYSIS: Section 46A.2 of the 2003 Budget Act authorized issuance of up to $6,780,000 in special indebtedness[35] for the cost of design, construction drawings, and administrative funds for solicitation of bids for up to three new juvenile Youth Development Centers and up to 500 beds and for utility work and site preparation for one of the three centers. The Department of Juvenile Justice and Delinquency Prevention (DJJDP) began preliminary planning using funds on hand soon after the 2003 Session. This planning process resulted in a consensus finding of DJJDP and its Advisory Council that the State should build smaller facilities located closer to a juvenile's family and local services. In 2004, DJJDP changed its recommendation to construction of up to 512 beds at up to 13 facilities.

The debt authorized in 2003 had not been issued when the 2004 Regular Session convened because DJJDP used internal funds to complete its preliminary planning. The Department of the State Treasurer and the State Bond Counsel indicated that before debt could be issued to continue the planning process, the language in the 2003 provision would have to be modified to reflect any expansion in project scope. This act makes those modifications by expanding the maximum number of facilities from 3 to 13 and the maximum number of beds from 500 to 512.[36]

This act does not authorize any new debt. It reauthorizes the same type of debt but at a lower amount due to the change in project scope and schedule. The act reduces the amount authorized from $6,780,000 to $4,460,000. The act restricts the use of these funds to design, construction drawings, and bid solicitation, repealing the original authorization for utility infrastructure and site work for one of the centers.[37] The reduced amount of $4,460,000 is the actual amount needed to complete all planning and design steps prior to starting construction according to the State Construction Office.

ELIMINATE IRB WAGE STANDARD.

Session Law	*Bill #*	*Sponsor*
S.L. 2004-132	**SB 1063**	**Senator Hartsell**

AN ACT TO ELIMINATE THE WAGE STANDARD FOR INDUSTRIAL REVENUE BONDS.

OVERVIEW: This act eliminates the wage standard for industrial revenue bonds and directs the North Carolina Department of Commerce to encourage projects applying for these bonds to locate the projects in development zones. The Act was recommended by the Joint Select Committee on Economic Growth and Development.

FISCAL IMPACT: The Department of Commerce believes that the impact of the additional financing on State personal income tax collections (from the tax-exempt interest) will be

[35] See the summary for S.L. 2004-179 for an explanation of special indebtedness.

[36] Section 16.3 of S.L. 2004-124, the 2004 Budget Act, outlines the type of planning and design information that DJJDP is required to submit to various committees before starting construction.

[37] The General Assembly determined that the cost of site work and infrastructure should not be authorized at the planning stage; it felt these costs should be included as part of construction costs. In S.L. 2004-179, the General Assembly authorized $35 million of special indebtedness for the construction of up to five youth development centers totaling up to 224 beds.

insignificant, because practically all of the industrial revenue bonds are purchased by large nationwide mutual funds. Consequently, the share of the new projects held in mutual funds by North Carolina residents will be small.

EFFECTIVE DATE: This act became effective when signed into law by the Governor on July 29, 2004.

ANALYSIS: Industrial revenue bonds offer manufacturing companies long-term debt financing at interest rates substantially below the prime rate. Under the industrial revenue bond program in North Carolina, a local financing authority may enter into a financing agreement to provide revenue bond proceeds to a company engaged in some manner of manufacturing to be used only to finance capital expenditures such as fixed assets, land, buildings, new equipment, existing equipment, architects and engineer's fees, and issuance costs. The amounts payable by the company to the authority under the financing agreement must be sufficient to pay all of the principal and interest on the bonds. The bonds are tax-exempt, and do not constitute a debt of the State.

Prior to this act, the manufacturing company for whom the bonds were to be issued was required to pay an average weekly manufacturing wage that was either above the average weekly manufacturing wage in the county or was at least 10% above the average weekly wage in the State.[38] Upon the recommendation of the Joint Select Committee on Economic Growth and Development, the act eliminates this wage standard for industrial revenue bonds.[39] Several local economic developers, as well as the North Carolina Department of Commerce, recommended this change to the Joint Select Committee. Manufacturers and economic developers reported that it is often difficult to meet the wage standard because the companies that can most benefit from industrial revenue bond financing are often those in manufacturing sectors that pay lower wages than manufacturers as a whole. The Joint Select Committee believed that the removal of the wage standard from the industrial revenue bonds would help support small and medium-sized manufacturing companies that need to retool to remain competitive in the global market.

The act also directs the North Carolina Department of Commerce to encourage projects applying for industrial revenue bonds to locate the projects in development zones. Development zones are economically distressed areas located within cities.

DELAYS $ LIMIT ON CREDIT FOR PARTNERSHIPS.

Session Law	*Bill #*	*Sponsor*
S.L. 2004-134	**HB 1602**	**Representative McComas**

AN ACT TO DELAY THE IMPOSITION ON PARTNERSHIPS OF THE DOLLAR AMOUNT LIMITATION ON THE CREDIT ALLOWED FOR REAL PROPERTY DONATIONS.

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[38] The William S. Lee Quality Jobs and Business Expansion Act also requires certain taxpayers to meet a wage standard to be eligible for the credits under the Act. A taxpayer located in enterprise tiers three through five must pay at least 110% of the applicable weekly wage to be eligible for a credit.

[39] The Joint Select Committee on Economic Growth and Development is an interim committee consisting of 28 members appointed by the President Pro Tempore of the Senate and the Speakers of the House of Representatives. The Committee issued a report to the 2003 General Assembly and is to terminate upon the convening of the 2005 General Assembly.

OVERVIEW: This act was a recommendation of the Environmental Review Commission. It postpones from 2005 until 2006 the imposition on partnerships and limited liability companies of the dollar amount limitation on the credit allowed for real property donations and provides that the Revenue Laws Study Committee should study the credit.

FISCAL IMPACT: Assuming 20 donations per year, this act would result in a General Fund revenue loss of approximately $3.7 million annually. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2004 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective when signed into law by the Governor on July 29, 2004.

ANALYSIS: The income tax credits in G.S. 105-151.12 and G.S. 105-130.34 are allowed to individual and corporate taxpayers who make a qualified donation of an interest in North Carolina real property that is useful for conservation purposes. The tax credit is equal to 25% of the fair market value of the property donated to the State, a local government, or an entity that is both organized to receive and administer lands for conservation purposes and qualified to receive tax deductible charitable contributions. The credit for a corporation may not exceed $500,000. The credit for an individual may not exceed $250,000. Both corporate and individual taxpayers are allowed to carry forward for five years any unused portion of the credit.

In S.L. 2001-335, the General Assembly corrected and clarified the law governing allocation of partnerships' tax credits, so that any dollar amount limitation on a credit applies to the total credit allowed to a partnership. The limited amount is then allocated by the partnership among the partners on a proportional basis. Before this change, the limit applied separately to each partner. The 2001 act delayed this dollar amount limitation until 2005 for partnerships that are allowed a credit for real property donations. This act postpones for one more year the imposition of the dollar amount limitation on partners taking this credit. As a result, the maximum dollar amount limits on this credit will continue to apply separately to each partner until 2006.

This act also authorizes the Revenue Laws Study Committee to study the credit and report its findings to the 2005 General Assembly by February 1, 2005.

N.C. VINEYARD AMENDMENTS.

Session Law	*Bill #*	*Sponsor*
S.L. 2004-135	**SB 74**	**Senator Rand**

AN ACT CONCERNING WINERY PERMITS.

OVERVIEW: This act redefines the terms "fortified wine" and "unfortified wine" and provides that ABC stores may continue to sell those wine products that met the definition of "fortified wine" before the change. This act also allows unfortified wineries to receive and sell wine produced under contract with the winery and allows those wineries to sell the contract wine at affiliated retail outlets.

FISCAL IMPACT: No estimate available. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2004 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act becomes effective October 1, 2004

ANALYSIS: Under North Carolina law before the enactment of this act, "unfortified wine" was defined as a wine that has an alcoholic content produced only by natural fermentation or by the addition of pure cane, beet, or dextrose sugar. "Fortified wine" was defined as any wine made by fermentation from grapes, fruits, berries, rice, or honey, to which nothing had been added other than pure brandy made from the same type of grape, fruit, berry, rice, or honey that is contained in the base wine, and which had an alcoholic content of not more than 24% alcohol by volume. The law made no distinction between unfortified wine and fortified wine on the basis of alcoholic content. This act changes the definitions of "unfortified wine" and "fortified wine" so that the distinction between the two is based solely on alcoholic content. Under this act, both unfortified wine and fortified wine are defined as any wine made by fermentation from grapes, fruit, berries, rice, or honey regardless of whether pure cane, beet, or dextrose sugar is added and regardless of whether pure brandy from the same type of grape, fruit, berry, rice or honey is added. Under the new definitions, the distinguishing feature between fortified and unfortified wine is the alcoholic content. Unfortified wine has an alcoholic content of less than 16% whereas fortified wine has an alcoholic content of between 16% and 24%. A wine that has an alcoholic content in excess of 24% continues to be classified as a spirituous liquor.

In North Carolina, unfortified wine is taxed at a rate of 21 cents per liter whereas fortified wine is taxed at a rate of 24 cents per liter. This act will change the classification of some products, resulting in a different rate of tax being imposed on those products.

Under North Carolina law before the enactment of this act, ABC stores were allowed to sell fortified wine in addition to spirituous liquor. This act contains a savings clause that allows ABC stores to continue to carry products that were classified as fortified wine by the ABC Commission prior to July 7, 2004, regardless of whether the products would have a sufficient alcoholic content to meet the new standard for fortified wine.

This act also allows the holder of an unfortified winery permit to receive and sell at the winery and at certain affiliated retail outlets unfortified wine produced under contract with the winery. The winery must also make this wine available to wholesalers. In general, the holder of an unfortified winery permit may manufacture unfortified wine and may sell, deliver, and ship the wine in closed containers to licensed wholesalers. The winery is allowed to make retail sales of wine "owned" by the winery if it obtains the appropriate permits. This act expands the class of wine that a winery may own and sell at retail and wholesale. Before the enactment of this act, under limited circumstances, the winery could also receive and sell at wholesale unfortified wine produced under the winery's label outside North Carolina from fruits owned by the winery.

Finally, this act restricts the ability of a holder of an unfortified winery permit to obtain a wine wholesaler permit. Under North Carolina law prior to the enactment of this act, the holder of an unfortified winery permit could obtain a wine wholesaler permit when that permittee had annual sales of less than 300,000 gallons of wine manufactured by it at the winery to people other than exporters or nonresident wholesalers. This act tightens that restriction by allowing a wine wholesaler permit only to those permittees that have annual sales of less than 100,000 gallons of wine manufactured by it at the winery to people other than exporters or nonresident wholesalers.

RENEWABLE FUEL TAX CREDITS.

Session Law	*Bill #*	*Sponsor*

S.L. 2004-153	HB 1636	Representative Tolson

AN ACT TO PROVIDE TAX CREDITS FOR DISPENSING AND PROCESSING RENEWABLE FUELS.

OVERVIEW: This act creates two new income or franchise tax credits for constructing renewable fuel facilities effective beginning in 2005: a 15% credit for a facility to dispense renewable fuel and a 25% credit for a facility to produce renewable fuel. Renewable fuel is defined as biodiesel or ethanol.

FISCAL IMPACT: Not determinable. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2004 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act is effective for taxable years beginning on or after January 1, 2005.

ANALYSIS: Article 3B of Chapter 105 of the General Statutes allows an income or franchise tax credit of 35% of the cost of constructing or purchasing renewable energy property, up to $250,000 per installation for non-residential property. Renewable energy property may include equipment for producing biodiesel or ethanol.

This act adds two new credits to Article 3B, a 15% credit for the costs of constructing a facility for dispensing renewable fuel and a 25% credit for the costs of constructing a facility for producing renewable fuel. Unlike the other Article 3B renewable energy property credit, these credits are not limited to a certain amount per facility. The dispensing credit must be taken in three annual installments and the production credit must be taken in seven annual installments. There is no double credit – the taxpayer must choose between any available credits and take only one with respect to the same costs.

Like the other credits in Article 3B, the new credits enacted by this act may be claimed against income tax or franchise tax. Each credit is limited to 50% of the amount of tax liability against which it is claimed. Any excess may be carried forward for up to five years. Although Article 3B is set to sunset January 1, 2006, the sunset for these two new credits would be 2008.

REVENUE LAWS TECHNICAL CHANGES.

Session Law	*Bill #*	*Sponsor*
S.L. 2004-170	**SB 1145**	**Senator Hartsell**

AN ACT TO MAKE TECHNICAL AND CONFORMING CHANGES TO THE REVENUE LAWS AND RELATED STATUTES, TO CLARIFY THAT THE CREDIT FOR CREATING JOBS IS ALLOWED ONLY FOR NEW JOBS CREATED IN THIS STATE, AND TO PROHIBIT THE USE OF FUTURE ROOM TAX COLLECTIONS IN CERTAIN COUNTIES AND CITIES TO DEVELOP OR CONSTRUCT A HOTEL OR SIMILAR LODGING FACILITY.

OVERVIEW: This act makes three substantive changes and many technical and clarifying changes to the revenue laws and related statutes.

FISCAL IMPACT: The estate tax clarification in Section 4 is expected to cause a General Fund revenue gain of $5.4 million in fiscal year 2005-2006. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2004 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: Except as otherwise provided, the act became effective when signed into law by the Governor on August 3, 2004.

ANALYSIS: This act makes three substantive changes and makes the following technical and clarifying changes to the revenue laws and related statutes. The substantive changes are in Sections 16, 42, and 43. The Revenue Laws Study Committee recommended the changes in Sections 1-8, 9-22, and 33-39.

Section	Explanation
1	Clarifies that estate tax changes have uniform sunset date.
2	Supplies a missing cross-reference in the University of North Carolina self-liquidating bond legislation.
3	Reenacts the 2003 session law relating to ESC surtax delay, in order to correct a technical omission. Effective as of date 2003 act became law, August 12, 2003, and repealed when the 2003 act is repealed.
4	Clarifies that calculation of State estate tax without regard to federal phase-out and termination of federal credit for state death taxes includes disregarding the federal deduction that replaces the federal credit January 1, 2005. North Carolina's estate tax is calculated based upon the federal estate tax base. Effective January 1, 2005, federal law will allow a deduction for State death taxes paid in lieu of the previously allowed credit for State death taxes paid. To prevent a circular calculation for State estate tax purposes, Section 4 clarifies that the State estate tax is calculated without regard to the federal deduction. This clarification results in an addition to the federal taxable estate for North Carolina estate tax purposes that is equal to the amount of the federal deduction for State death taxes paid. The estates affected by the enactment of this section are those for deaths occurring between January 1, 2005, and June 30, 2005. Effective July 1, 2005, the North Carolina will estate tax will sunset unless the General Assembly enacts legislation.
5	Deletes obsolete provisions.
6	Deletes definition of term no longer used in statutes.
7	Corrects grammatical issue.
8	Updates terminology in controlled substance tax law and clarifies provision complying with Fifth Amendment protection against self-incrimination.
8.1	Clarifies the mechanism for calculating the franchise tax on LLC assets attributed to a controlling corporation.
9	Adds cross-reference to defined term.
10	Provides that Bill Lee Act health insurance requirement begins when jobs are created or when qualifying investment is made and continues when credit, installment, or carryforward is claimed. Before this change, the statute referred only to when installment or carryforward is claimed. This change conforms to the current practice of the Department.
11	Clarifies that Bill Lee Act tax debt requirement begins when credit is claimed and continues when installment or carryforward is claimed. Before this change, the statute referred only to when installment or carryforward is claimed.
12	Delays report deadline by one month in order to allow time for quality of report to be improved.

Section	Explanation
13	Clarifies that loss of the Bill Lee machinery and equipment tax credit because property is disposed of is the same if the property is taken out of service or moved out of state.
14	Corrects incorrect cross-reference
15	Updates terminology. In 1977, the Federal Energy Regulatory Commission replaced the Federal Power Commission established in 1920. It is responsible for issuing licenses for the development of water and electrical power and prohibiting operators from restricting output or restraining trade in electrical energy.
16	Provides that in determining whether a taxpayer is eligible for the new tobacco export credit, positions located within North Carolina for six months or less are not considered to be part of the taxpayer's employment level. Eligibility is based on maintaining an employment level that exceeds by a certain amount the taxpayer's employment level at the end of 2004. Also corrects cross-references. Effective on the same dates as the new credit it amends.
17	Deletes cross-reference to repealed statute.
18	Clarifies the prepared food definition exception for food that is sliced, repackaged, or pasteurized by the retailer.
19	Restores provision inadvertently deleted in earlier legislation.
20	Corrects erroneous language.
21	Removes extraneous language that resulted from redlining conflicts between two laws enacted in 2003. Effective on same date as 2003 laws, July 1, 2004.
22	Corrects cross-reference.
22.5	Clarifies prohibition against using debt collection fee for any purpose not directly related to collecting overdue tax debts. If the fee were used for another purpose, it would be a penalty and all proceeds would be required by the Constitution to go to public schools.
23	Restores reference to the Division of Motor Vehicles that was inadvertently deleted from secrecy provision by 2003 legislation.
24	Removes administration option that is not used and is not allowed by the International Fuel Tax Agreement, which North Carolina has followed since 1992.
25	Clarifies when penalty applies and expands who the penalty is paid to, in order to reflect recent reorganization of the Division of Motor Vehicles.
26	Modernizes language.
27	Adds additional examples of fuels included in definition of diesel fuel. This definition applies in the fuel tax and inspection tax statutes.
28	Extends to letters of credit the condition requirements that apply to bonds.
29	Provides that licensee rather than Department of Revenue will make extra copies of license when there is more than one place of business.
30	Clarifies that biodiesel and all fuel alcohols are treated the same as fuel grade ethanol. This change conforms to the practice of the Department of Revenue.
31	Corrects incorrect terminology.
32	Adds missing reference to Mecklenburg one-cent sales tax.
33	Corrects incorrect terminology.
34	Conforms cross-references to reflect statutes repealed and added in 2003.
35	Provides that the property tax subcommittee of the Revenue Laws Study Committee may consist of up to eight members.

Section	Explanation
36	Conforms the date for filing a local occupancy tax return to the recently amended date for filing a monthly sales tax return. The provision is intended to conform both the filing date and the payment date. Effective October 1, 2004.
37	Conforms title of Article to reflect addition of Part 3 in 2003.
38	Clarifies that county economic development and training districts are special tax areas authorized by Section 2(4) of Article V of the N.C. Constitution.
39	Conforms purposes for which economic development and training district taxes may be levied to match the purposes for which the districts may be created.
40, 41	Codifies uncodified portions of a 1987 Session Law and reorganizes the codified portions of the same law.
42	For local occupancy taxes subject to the uniform provisions for occupancy taxes, this section prohibits the use of the tax proceeds to develop or construct a hotel or similar facility.[40] The rationale for this change is that local occupancy taxes collected by hotels and motels should not be used to subsidize their competitors. This change applies only to future collections of tax. The change does not affect Wake or Mecklenburg County. It affects only those local governments that are subject to the uniform provisions governing occupancy taxes. The governments covered by the uniform provisions as of August 2004 are listed below: Anson, Brunswick, Buncombe, Cabarrus, Camden, Carteret, Craven, Cumberland, Currituck, Dare, Davie, Durham, Granville, Madison, Montgomery, Nash, New Hanover, Pender, Person, Randolph, Richmond, Rowan, Scotland, Stanly, Transylvania, Tyrrell, Vance, and Washington Counties. The Cities of Gastonia, Goldsboro, Greensboro, High Point, Kings Mountain, Lexington, Lincolnton, Lumberton, Monroe, Mount Airy, Shelby, Statesville, Washington, and Wilmington, the Towns of Beech Mountain, Blowing Rock, Carolina Beach, Carrboro, Kure Beach, Jonesville, Mooresville, North Topsail Beach, Selma, Smithfield, St. Pauls, Wilkesboro, and Wrightsville Beach, and the municipalities in Avery and Brunswick Counties.
43	Amends the Bill Lee Act credit for creating new jobs to allow the credit only for jobs created in a taxable year that represent a net increase over the number of North Carolina employees the taxpayer had during the 12 months preceding the taxable year. If the taxpayer cut jobs in one year and then added jobs in the next year, the credit would be allowed only to the extent of a net increase over the previous year. Effective beginning with the 2004 tax year.

EXEMPT HIGHER ED. PROPERTY.

Session Law	*Bill #*	*Sponsor*
S.L. 2004-173	**SB 277**	**Senator Rand**

[40] Section 60 of S.L.2004-199, 2004 Technical Corrections, amended this section by deleting the phrase 'directly or indirectly'.

AN ACT TO EXEMPT FROM PROPERTY TAX EDUCATIONAL PROPERTY HELD BY A NONPROFIT ENTITY FOR A PUBLIC OR PRIVATE UNIVERSITY OR COMMUNITY COLLEGE LOCATED IN NORTH CAROLINA.

OVERVIEW: This act expands the property tax exemption for educational property by (1) exempting property held by a nonprofit entity for the sole benefit of a public or private university located in the State, a community college, or a combination of these entities and (2) expanding the definition of educational purposes to include the operation of a student housing facility or a student dining facility.

FISCAL IMPACT: The act does not affect General Fund revenues. It may result in a local government revenue loss. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2004 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The act is effective for taxes imposed for taxable years beginning on or after July 1, 2004.

ANALYSIS: This act expands the property tax exemption for educational institutions to include real property owned by a non-profit entity for the sole benefit of any one or more of the following:

- A constituent or affiliated institution of The University of North Carolina.
- An institution as defined in G.S. 116-22 which includes an institution with a main permanent campus in the State that is not owned or operated by the State and is accredited by the Southern Association of Colleges and Schools, awards a postsecondary degree, and is not a seminary, Bible school, Bible college or similar religious institution.
- A community college.

To be exempt, the property must be exclusively used for an educational purpose. An "educational purpose" is defined as one that has as its objective the education or instruction of human beings, or comprehends the transmission of information and the training or development of knowledge or skills of individual persons. The term specifically includes the operation of a golf course, tennis court, sports arena, similar sports property, or similar recreational sport property for the use of students or faculty, regardless of the extent to which the general public uses the property. This act amends the definition of "educational purpose" to include the operation of a student housing facility or a student dining facility.

FINANCE VITAL PROJECTS/STUDIES.

Session Law	*Bill #*	*Sponsor*
S.L. 2004-179	**HB 1264**	**Representative Miner**

AN ACT TO AUTHORIZE THE ISSUANCE OF SPECIAL INDEBTEDNESS TO FINANCE VITAL STATE FACILITIES FOR HEALTH CARE AND BIOTECHNOLOGY RESEARCH, TO CREATE THE DEBT AFFORDABILITY ADVISORY COMMITTEE, AND TO DIRECT THE BOARD OF GOVERNORS OF THE UNIVERSITY OF NORTH CAROLINA AND THE STATE BOARD OF COMMUNITY COLLEGES TO CONTRACT WITH A PRIVATE CONSULTING FIRM TO STUDY UNIVERSITY AND COMMUNITY COLLEGE PROGRAMMING AND CAPITAL NEEDS.

OVERVIEW: This act does all of the following:

- Authorizes the State to use special indebtedness to finance construction of five new projects in the University of North Carolina (UNC) system and land acquisition and planning for five other projects in the UNC system.
- Authorizes the State to use special indebtedness to finance construction of up to five youth development centers.
- Requires the Health and Wellness Trust Fund and the Tobacco Trust Fund[41] each to transfer to the General Fund annually one-half the estimated debt service on the UNC and youth facility indebtedness. The amount transferred each fiscal year is capped at 30% of the trust fund's receipts through 2006-2007 and 65% beginning in 2007-2008.
- Authorizes the State to use special indebtedness for capital projects (1) for the State Parks System, (2) for parks, recreation, and the preservation of natural heritage, and (3) for clean water conservation. Repayment of the debt for these purposes would be made from existing revenue streams dedicated to the Parks and Recreation Trust Fund, the Natural Heritage Trust Fund, and the Clean Water Management Trust Fund, respectively. The authorization is limited to a total of $45 million: $20 million to acquire land near military bases and $25 million for land acquisition for new and existing State parks and gamelands and capital improvements for existing State parks.
- Requires the Parks and Recreation Authority to allocate funds from the Trust Fund with a geographic distribution across the State to the extent practicable.
- Clarifies that revenue in the trust funds is annually appropriated for the purposes for which expenditures are authorized.
- States the intent of the General Assembly that the purposes for which parks, heritage, and clean water indebtedness may be incurred include, as a high priority, acquiring land near military bases to prevent encroachment.
- Provides that none of the parks, heritage, and clean water debt proceeds may be used to acquire property by eminent domain.
- Creates a Debt Affordability Advisory Committee, which would be responsible for preparing an annual debt affordability study and establishing guidelines for evaluating the State's debt burden.
- Directs the UNC Board of Governors and the State Board of Community Colleges to contract with a consultant to study higher education program and facility needs.[42]

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[41] In late 1998, forty-six states and several U.S. territories reached an agreement to settle the lawsuits they had filed against the major cigarette manufacturers. The terms of the settlement were incorporated into an agreement known as the Master Settlement Agreement. The Master Settlement Agreement contractually imposes some restrictions on tobacco marketing and requires the tobacco companies to make annual payments to the states. As part of the North Carolina consent decree, the judge (at the request of the Attorney General) awarded 50% of the settlement funds to the State's Settlement Reserve Fund and 50% to a nonprofit corporation, the Golden L.E.A.F. Foundation, that will assist tobacco-dependent and economically-affected communities. The 50% that is paid to the Settlement Reserve Fund is divided equally between the Health and Wellness Trust Fund and the Tobacco Trust Fund.

[42] See Section 51 of S.L.2004-199, the 2004 Technical Corrections.

- Enacts a statutory framework for a new type of State special indebtedness called "RECOP indebtedness," which would involve lower debt service payments during the term of the debt in exchange for a larger payment due at maturity. RECOP indebtedness could not be issued unless the General Assembly enacted legislation specifically providing for the projects or refunding to be financed with RECOPs.
- Directs the Treasurer to study RECOP indebtedness and report to the Joint Legislative Commission on Governmental Operations by February 1, 2005.

FISCAL IMPACT: The net General Fund cost is expected to be zero because the act requires the annual transfer of revenue from other sources to the General Fund in an amount to cover the estimated debt service. The maximum annual debt service is $47.4 million in fiscal year 2010-2011. The total interest on the $468 million of debt is $310.2 million. The annual debt service amounts are affected by the cash flow needs of each project as well as the $310 million limit on the amount of debt that may be issued during the 2004-2005 fiscal year. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2004 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: Except as otherwise indicated, this act became effective when signed into law by the Governor on August 5, 2004.

ANALYSIS: This act authorizes the State to issue up to $468 million of special indebtedness to finance various capital projects; no more than $310 million of the special indebtedness may be issued during the 2004-2005 fiscal year. The debt service for the UNC System facilities and the Youth Development Centers will be reimbursed from the Health and Wellness Trust Fund and the Tobacco Trust Fund. The debt service for the Parks, Natural Heritage, and Clean Water management projects is fully funded by the streams of revenue available to the Parks and Recreation Trust Fund, the Natural Heritage Trust Fund, and the Clean Water Management Trust Fund.

Health, Education, and Youth Facilities

This act authorizes the issuance of special indebtedness for constructing the following capital projects:

Purpose	Amount in Millions
Cancer Center at UNC-Chapel Hill	$180
Cardiovascular Institute at Eastern Carolina University	60
Bioinformatics Center at UNC-Charlotte	35
Facility for Pharmacy Program at Elizabeth City State University	28
UNC-Asheville Health Center	35

It also authorizes the issuance of special indebtedness for land acquisition, site preparation, and planning for the following capital projects:

Purpose	Amount in Millions
Fayetteville State University Teaching/Nursing Center	$10
North Carolina A&T/UNC-Greensboro Millennial Campus	10
Optometry School at UNC-Pembroke	10
Western Carolina University for joint Health & Aging Center	10

In addition to the issuance of $388 million of special indebtedness authorized for higher education projects, the act authorizes the issuance of up to $35 million of special indebtedness to construct up to five youth development centers. The timing for the issuance of the debt for these purposes is limited so that no more than $278 million in debt can be issued before July 1, 2005. The remainder can be issued on or after that date.

The act provides that a portion of the funds available to the Health and Wellness Trust Fund[43] and the Tobacco Trust Fund[44] will be used to reimburse the General Fund each year for debt service on the UNC and youth facility debt. Each trust fund is required to transfer to the General Fund annually one-half of the debt service amount certified by the Treasurer. The required transfer from each trust fund is capped, however, at a percentage of current year receipts. The percentage is 30% through 2006-2007 and then increases to 65% in 2007-2008. The cap allows the trust funds to retain a portion of their funding to develop future programs and award grants.[45] These provisions became effective July 1, 2004.

Commonly referred to as "certificates of participation," special indebtedness is nonvoted debt that maybe secured only by an interest in State property being acquired or improved. There is no pledge of the State's faith and credit or taxing power to secure the debt. Thus, voter approval is not necessary for the borrowing. If the State defaulted on its repayments, no deficiency judgment could be rendered against the State, but the State property that serves as security could be disposed of to generate funds to satisfy the debt. The State could choose not to appropriate funds to repay the debt, but such a decision would have negative consequences for the State's credit rating.

The term "special indebtedness" is employed to cover the three forms that this type of debt can take: installment purchase (with or without certificates of participation), lease-purchase (with or without certificates of participation), and bonds. The particular form to be used for a given project will depend on its size, the nature of the property and the improvement, and other circumstances. Based on these circumstances, one form or another of special indebtedness may be the least expensive and most practical for the State to utilize. Article 9 of Chapter 142 of the General Statutes prohibits the issuance of special indebtedness except for projects specifically authorized by the General Assembly.

Before special indebtedness could be issued or incurred, the State Treasurer must certify that debt financing may be desirable for a specific project presented to it by the Department of Administration. Next, the Council of State must give preliminary approval. If preliminary approval is obtained, the Council of State must give final approval, setting out details such as the maximum amount to be financed, the maximum maturity, and the maximum interest rates. The maximum maturity may not exceed 40 years. The State Treasurer must approve the details

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[43] The Health and Wellness Trust Fund receives annual tobacco settlement payments to be used to improve the health and wellness of North Carolinians. In order to build up a fund reserve for future projects, the governing body of the Trust Fund has been required to reserve 50% of each annual payment since 2001. This act eliminates the requirement that 50% of the Trust Fund's annual receipts be reserved.

[44]The Tobacco Trust fund receives annual tobacco settlement payments to be used to assist tobacco producers, tobacco allotment holders, and persons engaged in tobacco related businesses.

[45] The Tobacco Trust Fund awards grants on an annual basis based on availability of funds. The bulk of the Heath and Wellness Trust Fund's current commitments is the Senior Cares prescription drug program; this program is scheduled to terminate in fiscal year 2005-2006 at which time the Medicare senior prescription drug program will be available for seniors.

of the financing, finding that the amount to be borrowed is adequate and not excessive and will not require an excessive increase in any State revenues to provide for repayment, and that the special indebtedness can be incurred or issued on terms favorable to the State. Finally, the State Treasurer must report to the Joint Legislative Commission on Governmental Operations at least five days before any special indebtedness is issued or incurred.

Parks Renovation and Acquisition

The act authorizes the State to issue or incur up to $45 million of special indebtedness to finance the acquisition of property for three programs:

- The Parks and Recreation Trust Fund for repairs and renovations of park facilities and capital projects and land acquisition for the State Parks System.
- The Natural Heritage Trust Fund to acquire land that represents the ecological diversity of the State and land for State parks, wildlife areas, and similar public purposes.
- The Clean Water Management Trust Fund for capital projects to acquire riparian buffers, acquire property interests to conserve surface water and drinking water supplies, coordinate with other public programs for lands adjoining water bodies, and restore the ability of degraded lands to protect water quality.

The proceeds of the indebtedness may not be used to acquire property by eminent domain. The act states the intent of the General Assembly that the purposes for which the debt proceeds may be used include, as a high priority, acquiring land near military bases to prevent encroachment.

The amount of debt that may be incurred is limited to the lesser of a dollar amount for each purpose authorized and the amount that can be supported by the funds set aside from the three Trust Funds for annual debt service payments. The three trust funds will have to work together to keep the total debt below the maximum dollar amounts for the authorized projects, which are as follows:

$20 million	Acquire property near military bases to prevent encroachment
$25 million	Land acquisition for existing and new State parks and capital projects for an existing State park

The timing for the issuance of the debt for these purposes is limited so that no more than $32 million in debt can be issued before July 1, 2005. The remainder can be issued on or after that date.

These three Trust Funds have dedicated revenue sources. The Parks Fund and the Natural Heritage Fund both receive a stream of revenue from the State excise tax on conveyances (the "deed stamp tax") and from vanity license plate fees. The Clean Water Management Trust Fund receives a statutory annual appropriation of $100 million. This act authorizes the governing body of each Fund to allocate a portion of its stream of income for debt service on debt incurred to acquire property.[46]

[46]The three Trust Funds receive annual statutory transfers and/or appropriations that they are authorized to use for the purposes provided by statute. The Parks and Recreation Trust Fund statute specifically provides that the moneys in the trust fund are annually appropriated for those purposes. This act adds similar language to clarify that the moneys in the Natural Heritage Trust Fund and the Clean Water Management Trust Fund are also annually appropriated for the purposes authorized by statute.

In the case of the Parks and Recreation Trust Fund, the Authority can allocate up to 50% of the two-thirds portion of their income designated for repairs and renovations of park facilities and capital projects and land acquisition for the State Parks System for debt service. The Authority may not allocate any of the income currently designated for local government grants or for beach access. In addition to authorizing use of a portion of the Fund for debt service, the act also requires any allocations from the Fund to be geographically distributed across the State to the extent practicable. Under prior law, the governing body of the Fund had to 'consider' geographic distributions across the State to the extent practicable.

In the case of the Natural Heritage Trust Fund, up to 50% of the annual receipts may be allocated for debt service. In the case of the Clean Water Management Trust Fund, the $45 million cap on outstanding debt automatically limits the allocation to a small fraction of the annual income stream.

The governing body of each trust fund can select a project and allocate a portion of the fund's revenue stream for special indebtedness to finance the project. Once the debt is issued, the governing body is required to credit the debt service amount to the General Fund each year.

Debt Affordability Advisory Committee

The act creates a Debt Affordability Advisory Committee to annually advise the Governor and the General Assembly on the estimated debt capacity of the State for the upcoming 10 fiscal years. The Committee must undertake an annual debt affordability study and establish guidelines for evaluating the State's debt burden.

The Committee consists of the State Treasurer, the Secretary of Revenue, the State Budget Officer, the State Auditor, the State Controller, and four members of the public – two appointed by the President Pro Tempore of the Senate and two appointed by the Speaker of the House of Representatives. The State Treasurer serves as the chair of the Committee and the Committee meets upon the call of the chair. The Committee must report its findings and recommendations to the Governor, the General Assembly, and the Fiscal Research Division by February 1 of each year.

In March 2003, the State Treasurer presented to the House and Senate Finance Committees a debt affordability study for North Carolina. The study evaluated the State's current and projected debt burden using indicators such as tax-supported debt to personal income, debt per capita, debt service to tax revenue, and rapidity of principal repayment ratios. The study recognizes that debt capacity is a limited and scarce resource and that an evaluation of the State's debt position can help policymakers evaluate the long-term impact of financing decisions and assist in prioritizing capital spending. The State Treasurer also noted in the report that credit rating agencies consider a debt affordability study as a positive factor when they evaluate issuers and assign credit ratings. The State Treasurer published a revised debt affordability study in 2004.

Study of Higher Education Program and Facility Needs

The act directs the UNC Board of Governors and the State Board of Community Colleges to contract with a consultant to conduct a comprehensive study of the mission and programming needs for the UNC system and the Community Colleges system, and to study facility needs related to the identified program needs. The act specifically states that the historically Black colleges and universities and UNC-Pembroke are valuable and indispensable assets of the UNC system and should not be diminished or eliminated. The boards and their consultant are required to make periodic reports to a subcommittee created by the Joint Legislative Education Oversight

Committee and submit to the Committee and the General Assembly a preliminary report by April 15, 2005, and a final report by December 31, 2005.

Statutory Framework for RECOPS

The act establishes the statutory framework for a new type of special indebtedness to be called Real Estate Certificates of Participation (RECOP) indebtedness. RECOP indebtedness is a form of special indebtedness that is intended to be structured so that the principal and a portion of the interest are not paid in installments over the term of the debt. That portion of the interest compounds and is payable, along with the principal, only at maturity or earlier redemption. This structure is intended to reduce ongoing debt service payments and provide for payment of the remaining obligation at a time when the property securing the debt will most likely have appreciated substantially in value.

Like other special indebtedness, RECOP indebtedness may be incurred only if the amount and specific purposes have been authorized in an act of the General Assembly. RECOP indebtedness differs from traditional special indebtedness in several ways:

- Special indebtedness may be incurred only for capital projects. RECOP indebtedness may be incurred to retire existing State debt as well as for capital projects.
- Special indebtedness may be secured only by the capital facilities being constructed, renovated, or repaired with the proceeds of the debt. RECOP indebtedness may be secured by these projects but may also be secured by any other State property. The property to serve as collateral would be selected by the Governor after first consulting with the Joint Governmental Commission on Governmental Operations. The choice of collateral must also be approved by the Council of State.
- State property law does not apply to a transfer of an interest in State property to secure special indebtedness or, in the case of default, to repay special indebtedness. With RECOP indebtedness, there is an additional exemption from State property law for transfers when the proceeds are used first to pay RECOP indebtedness, even if there is no default.

A major difference between RECOP indebtedness and the types of debt the State and local governments normally incur involves the payment of principal and interest. The usual practice is for the governmental entity to pay off the principal during the term of the debt while also paying interest. Normally, the outstanding principal balance declines relatively steadily during the term of the debt. With RECOP indebtedness, it is intended that no principal would be paid off during the term of the debt. In addition, it is intended that only part of the interest would be paid during the term of the debt. Postponing these payments until maturity makes the debt service payments during the life of the debt much lower than with traditional debt. The entire principal becomes due at maturity along with that portion of the interest that was not paid in installments.

Treasurer Study

The act requires the State Treasurer to conduct a study of RECOP indebtedness. The act states that there may be circumstances in which the State would benefit from taking advantage of flexible financing tools such as RECOPs, but that more information is needed for the General Assembly to consider such a policy decision. The act directs the State Treasurer to study the effects of using RECOPs either for new projects or refunding outstanding debt and to report the results of the study and any recommendations by February 1, 2005, to the Joint Legislative Commission on Governmental Operations.

WETLANDS REIMBURSEMENT/LOCAL TAX BASE.

Session Law	*Bill #*	*Sponsor*
S.L. 2004-188	**SB 933**	**Senator Hargett**

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

OVERVIEW: This act requires State and local government agencies that acquire land for wetlands mitigation in an enterprise tier one or tier two county to reimburse the county in which the land is located a sum equal to the estimated amount of property taxes that would have accrued to the county for the next 20 years. The requirement does not apply when the land purchased and the wetlands permitted to be lost are located in the same county.

FISCAL IMPACT: No General Fund impact. The Fiscal Research Division estimates the costs associated with this act to be $137,088 annually. Approximately 75% of this amount is expected to come from the Department of Transportation, with the balance drawn from the Wetlands Trust Fund. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2004 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The act became effective when it was signed into law by the Governor on August 17, 2004. It applies to transfers made on or after that date.

ANALYSIS: The Wetlands Restoration Program and Wetlands Trust Fund were established by the General Assembly in 1996 to restore wetlands[47] lost or impaired through human activities and to assist those who must meet wetlands mitigation requirements imposed by the United States Army Corps of Engineers as a condition of obtaining Section 404 permits for wetlands alteration.[48] Under federal environmental regulations, when wetlands are lost or impaired, other land in the same river basin or sub-river basin must be set aside to "make up" for the lost wetlands. This practice is referred to as compensatory wetland mitigation, and the State is subject to these federal requirements.

When a State agency or local government acquires wetlands for wetlands mitigation, that property becomes exempt from tax and is removed from the county's tax base. This act requires that the State and local governments reimburse a tier one or two county when they acquire[49] property within the county for the purpose of wetlands mitigation. The reimbursement amount is a sum that is equal to the estimated amount of property taxes that would have accrued to the county for the next 20 years had the land not been acquired by the State agency or local government. If a State agency acquires property in a county for future wetlands mitigation and later uses the property to mitigate wetlands permitted to be lost in the same county, then the county must return a portion of the reimbursement payment to the State. The amount reimbursed to the State agency is a percentage based upon the number of years the State agency held the land before the wetlands were lost.

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[47] Wetlands include pocosins, freshwater marshes, swamp forests, and bottomland hardwood forests.

[48] Section 404 of the United States Clean Water Act, which controls the placement of dredged or fill materials in the waters of the United States and adjoining wetlands, is the nearest thing to a national wetlands law.

[49] The acquisition may be made through condemnation or by purchase.

The requirement for reimbursement does not apply to the condemnation or acquisition of land by a city or special district if the land is located in the corporate limits of the city or special district, or within the county where the city or special district is located. The reimbursement requirement also does not apply to land acquired by a State agency when the land purchased by the State agency and the wetlands permitted to be lost are located in the same county. Lastly, the governing board of the county and the State agency may agree in writing to waive the payment.

The act further provides that if a State agency acquires wetlands in a tier one or two county from a private mitigation banking company, the agency must pay a sum in lieu of property tax to the county where the wetlands are located. However, as a condition of accepting the donation from the private mitigation banking company, the State agency may require the company to make adequate provisions for the long-term maintenance and management of wetlands. These provisions may include reimbursement to the agency for payment of a sum in lieu of property taxes. A private mitigation banking company trades in properties that may be eligible as mitigation lands.

Historically, the primary State agency purchasers of wetlands mitigation properties have been the North Carolina Department of Transportation, making purchases to mitigate road activity, and the Wetlands Restoration Program. In 2003, the compensatory mitigation efforts of these two agencies were joined through a Memorandum of Agreement between the parties and renamed the "Ecosystem Enhancement Program".

NC CEMETERY ACT/FEES/BILL LEE TIERS.

Session Law	*Bill #*	*Sponsor*
S.L. 2004-202	**SB 1244**	**Senator Hoyle**

AN ACT AUTHORIZING THE NORTH CAROLINA CEMETERY COMMISSION TO INCREASE CERTAIN FEES, MAKING CLARIFYING CHANGES UNDER THE NORTH CAROLINA CEMETERY ACT, AND MODIFYING THE FORMULA USED TO DETERMINE THE ENTERPRISE TIER DESIGNATION OF A COUNTY.

OVERVIEW: This act gives the North Carolina Cemetery Commission the authority to increase several fees and increases the amounts that must be deposited into care and maintenance trust funds. This act also modifies the tier structure in the Bill Lee Act to be more responsive to changes in a county's economic outlook by ranking a county's unemployment rate and per capita income annually as opposed to using a 3-year average.

FISCAL IMPACT: It is not possible to determine the impact of this act on the General Fund. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2004 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective when signed into law by the Governor on August 17, 2004.

ANALYSIS: This act gives the North Carolina Cemetery Commission the authority to increase the following fees:

- Annual renewal fee for licensed cemeteries.
- Inspection fee for each grave space, niche, or mausoleum crypt.

- Inspection fee for each vault, belowground crypt, memorial, or opening and closing of a grave space included in a preneed cemetery contract.
- Initial application and filing fee for cemetery company.
- Initial application and filing fee for cemetery sales organizations and cemetery management organizations.
- Initial application and filing fee for cemetery brokers.
- Annual renewal fee for cemetery sales organizations, cemetery management organizations, and cemetery brokers.
- Initial application and filing fee for persons selling preneed grave space.
- Biennial renewal fee for persons selling preneed grave space.
- Application and filing fee for approval of a change of control.

The Cemetery Commission is receipt supported and receives no State General Fund appropriations. At the time this act was enacted, the Commission had a negative fund balance. Therefore, the fee increases were necessary to fund continuing operations of the Commission.

To increase a fee amount, the North Carolina Cemetery Commission must go through the administrative rules process. In addition to the notice and public comment provided for under the administrative rules process, the Commission must also appear before the Joint Legislative Commission on Governmental Operations before an increased fee amount may become effective.

Cemetery companies must make timely deposits to a care and maintenance trust fund and must file with the North Carolina Cemetery Commission annual financial reports of the funds. This act increases the amounts that must be deposited into a care and maintenance trust fund for each grave space, niche, or mausoleum that is sold or is converted from a public or nonprofit cemetery to a private cemetery.

The act also changes the consequences of failing to make timely deposits or file timely financial reports. Under law prior to the enactment of this act, a cemetery company that failed to make a timely deposit in a trust fund was subject to a penalty of $1.00 per day for each day the deposit was delinquent and a cemetery company that failed to file timely annual financial reports was subject to a penalty of $25 per day for each day of delinquency. The proceeds of these penalties were not retained by the Cemetery Commission because under Article IX, Section 7 of the North Carolina Constitution, the clear proceeds of all penalties must be credited to the county's school fund. The Cemetery Commission incurs additional expenses when a person fails to submit deposits and reports in a timely fashion. Before the enactment of this act, this expense was borne by the Commission through the general licensing revenues. This act changes each penalty to a late filing fee. As a result, the Commission will be able to retain the fee proceeds to recover its additional expenses from the person who creates the need for the expense. This act also changes the late fee for failure to file timely financial reports from $25 a day to $25 a month.

Section 10 of the act modifies the formula used to determine the enterprise tier designation of a county under the Bill Lee Act. By December 31 of each year, the Department of Commerce is required to assign a tier designation to each of the 100 counties in the State. In order to make these assignments, the Department must rank all counties based on three factors, average rate

of unemployment over the preceding three years, average per capita income over the preceding three years, and percentage growth in population. Each of these factors is given equal weight. Tier designations are assigned based on the ranking, although there are numerous exceptions to this formula. A county designated as enterprise tier one or two may not be designated a higher tier until it has been at its current tier for at least two consecutive years. There are also exceptions for certain lower-population counties that could result in those counties receiving a lower designation.

This act changes the time frames for measuring each of the three factors. Under this act, in ranking counties on the basis of unemployment and per capita income, the Department will use the average figure over the last 12 months rather than over the past three years. In ranking the counties on the basis of population growth, the Department will use the population growth percentage over the past 12 months. Previously the statute specified no time frame for measuring population growth. In ranking counties on the percentage of population growth, the Department had compared the most recent estimate of population to the last decennial census figure. Thus, the period of time over which population growth was measured varied each year.

It is believed that these changes will make the Bill Lee tier designation more sensitive to changes in economic conditions in the counties. Because of various exceptions to the ranking formula, the distribution of counties will still be skewed toward the lower tiers.

Bill Lee tier designation affects a number of different State programs, including the following: Job Development Investment Grant (JDIG) Program, One North Carolina Fund, Industrial Development Fund, Community Development Block Grant funds, certain sales tax refunds, low-income housing tax credits, purchase of agricultural conservation easements, and distributions from the Spay/Neuter Account.

2003

ONE-TIME RENTAL CAR TAX ELECTION EXCEPTION.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-5	**SB 235**	**Senator Hoyle**

AN ACT TO ALLOW A RETAILER THAT LEASES MOTOR VEHICLES AND THAT HAS PAID THE HIGHWAY USE TAX ON THE MOTOR VEHICLES TO PAY AN ADDITIONAL GROSS RECEIPTS TAX ON THE MOTOR VEHICLES.

OVERVIEW: This act allows a retailer who leases motor vehicles to elect to begin paying the highway use tax on the gross receipts derived from leasing the vehicles even though the retailer has previously paid the 3% highway use tax on these vehicles. The retailer's election to begin paying the gross receipts tax must have been made by July 1, 2003 and if made, is irrevocable. The election does not relieve the retailer of liability from a tax previously imposed.

FISCAL IMPACT: This act has no fiscal impact. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2003 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective when signed into law by the Governor on March 28, 2003. An election to pay the gross receipts tax must have been made by the retailer by July 1, 2003.

ANALYSIS: In 1989, the General Assembly enacted the highway use tax to provide a major source of revenue for the Highway Trust Fund. The tax rate is 3% of the retail value of a motor vehicle for which a certificate of title is issued. The Division of Motor Vehicles collects the tax. A retailer that leases or rents motor vehicles may elect not to pay the highway use tax. Instead, the retailer may elect to pay an 8% tax on the gross receipts of the short-term lease or rental and a three percent (3%) tax on the gross receipts of long-term rentals. Although the gross receipts tax is imposed on the retailer, it is added to the lease or rental price of the vehicle and is ultimately paid by the person who leases or rents the vehicle. The gross receipts tax is collected by the Department of Revenue. The tax levied at 3% is credited to the Highway Trust Fund and the tax levied at 8% is credited to the General Fund.

This act allows a retailer who leases motor vehicles and who elected to pay the highway use tax on the retail value of the vehicles at the time the retailer obtained a certificate of title for those vehicles to collect the alternate gross receipts tax. In order to collect the gross receipts tax on these vehicles, a retailer must have submitted a written request to the Division of Motor Vehicles and the Department of Revenue by July 1, 2003. The retailer was required to specifically identify the vehicles to which the election applied, the date upon which the retailer would begin collecting the additional taxes, and any additional information needed to collect the tax. If a retailer elected to pay the gross receipts tax under this act, that election is irrevocable and does not relieve the taxpayer of liability for any tax previously imposed.

Typical practice throughout the rental car industry is for the highway use tax to be paid on the receipts of the rentals. Typically states that impose a tax on the leasing of vehicles impose a gross receipts tax. However, in North Carolina, at least one rental car retailer elected to pay the highway use tax at the time the retailer obtained the certificates of title for its fleet. To be

consistent with other companies in the industry and to be consistent among the various states in which the retailer leases its motor vehicles, the retailer requested authorization to collect the gross receipts tax on its rentals.

IRC UPDATE.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-25	**HB 320**	**Rep. McComas**

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

OVERVIEW: This act rewrites the definition of the Internal Revenue Code used in State tax statutes to change the reference date from May 1, 2002 to January 1, 2003. Part XXXVII-A of S.L. 2003-284 updated the reference date to June 1, 2003. (See summary for S.L. 2003-284 for more details.) Updating the Internal Revenue Code reference makes recent amendments to the Code applicable to the State to the extent that State law previously tracked federal law.

FISCAL IMPACT: This act results in a revenue gain of less than $30,000 per year. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2003 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective when signed into law by the Governor on April 24, 2003.

ANALYSIS: Congress enacted the Clergy Housing Allowance Clarification Act of 2002 (P.L. 107-181) which clarifies the amount that may be excluded from gross income by a minister for a rental allowance paid to the minister as part of the minister's compensation. Under previous federal law, the rental allowance was excluded to the extent the allowance was used to rent or provide a home for the minister. Specifically, new la provides that the rental allowance is excluded to the extent that it is used to rent or provide a home for the minister but only to the extent that it does not exceed the fair market rental value of the home.

This legislation originated as an effort to head off a constitutional challenge to the clergy housing exclusion in a case before the Ninth Circuit Court of Appeals, *Warren v. Commissioner of Internal Revenue*, 282 F.3d 1119 (9th Cir. 2002). In this case, Reverend Rick Warren had purchased a home and for three years excluded a portion of his compensation from his church on the basis of the rental allowance exclusion. The IRS determined that, pursuant to a 1971 Revenue Ruling, the amount excluded should have been limited to the fair market rental value of his home and assessed a deficiency. Rev. Warren contested the deficiency. In May 2000, the United States Tax Court ruled that the IRS erred in finding Rev. Warren's housing allowance exclusion was limited to the fair market rental value of his home. The government appealed the Tax Court decision to the Ninth Circuit Court of Appeals. Although neither party raised a constitutional issue on appeal, the Ninth Circuit, on its own, queried whether the rental allowance exclusion for ministers of the Code violated the Establishment Clause of the United States Constitution and requested the parties to submit briefs on that issue. This prompted the introduction of the Clergy Housing Allowance Clarification Act of 2002 as an effort by Congress to preserve the 81-year-old law exempting from federal income tax the provision of residential housing for clergy. The legislation moved swiftly thorough Congress, and two days after the President signed the measure, both parties in the case requested a dismissal of the appeal.

MODIFY COUNTY TAX CERTIFICATION AUTHORITY.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-72	**HB 393**	**Representative Stam**

AN ACT TO MODIFY THE AUTHORITY OF THE BOARD OF COUNTY COMMISSIONERS IN CERTAIN COUNTIES TO REQUIRE THE REGISTER OF DEEDS IN THE COUNTY NOT TO ACCEPT ANY DEED TRANSFERRING REAL PROPERTY FOR REGISTRATION UNLESS THE COUNTY TAX COLLECTOR CERTIFIES THAT NO DELINQUENT TAXES ARE DUE ON THAT PROPERTY.

OVERVIEW: This act provides that a register of deeds serving in a county where tax collector certification of a deed is normally required prior to registration must accept an uncertified deed if the closing attorney states the intent to pay any delinquent taxes from the closing proceeds. It also adds Hyde County to the list of counties that have the authority to require tax certification of a deed prior to registration.

FISCAL IMPACT: This act does not affect State revenues.

EFFECTIVE DATE: This act became effective when signed into law by the Governor on May 20, 2003.

ANALYSIS: G.S. 161-31 provides that in certain counties, the board of county commissioners may adopt a resolution to require the register of deeds to refuse to register a deed unless the county tax collector has certified that no delinquent taxes are due on the property. Before the 2003 Session, this provision applied to the following 45 counties: Alleghany, Anson, Beaufort, Bertie, Cabarrus, Camden, Carteret, Cherokee, Chowan, Clay, Cleveland, Currituck, Davidson, Durham, Forsyth, Gaston, Graham, Granville, Harnett, Haywood, Henderson, Hertford, Iredell, Jackson, Lee, Macon, Madison, Martin, Montgomery, Northampton, Pasquotank, Perquimans, Person, Pitt, Polk, Rockingham, Rowan, Rutherford, Stanly, Swain, Transylvania, Vance, Warren, Washington, and Yadkin Counties. This act adds Hyde County to the list. S.L. 2003-189 added Gates County and S.L. 2003-354 added Duplin County to the list, to bring the total to 48.

In addition to G.S. 161-31, the General Assembly has enacted similar laws that prohibit a register of deeds from registering a deed unless the tax collector has certified that no delinquent taxes are due. These provisions apply to the following local governments: Avery County (1963); Mitchell County (1987); Ashe County (1993); the Towns of Newland and Spruce Pine and Alleghany County (1997);[1] the Town of Banner Elk (1998); and the Town of Bakersville (1999).

In a county or local government where G.S. 161-31 and other similar State laws do not apply, the register of deeds registers deeds regardless of whether delinquent taxes are due on the property.

The purpose of G.S. 161-31 is to provide certain counties an additional tool to collect delinquent property taxes. This act amended G.S. 161-31 to provide that if the board of county commissioners has adopted a resolution to require the register of deeds to refuse to register a deed without the certification of the county tax collector, the register of deeds must still accept an uncertified deed that is submitted for registration under the supervision of a closing attorney and containing the statement, "This instrument prepared by: _____, a licensed

[11] Although Allegheny County had a local provision, it was added to G.S. 161-31 in 2001 because that provision allows the county to decide what form the certification will take.

North Carolina attorney. Delinquent taxes, if any, to be paid by the closing attorney to the county tax collector upon disbursement of closing proceeds." The change is intended to provide the same level of protection for counties while reducing the paperwork burden associated with transfers of real property.

PUBLISH REVENUE-NEUTRAL PROPERTY TAX RATE.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-264	**SB 511**	**Senator Rucho**

AN ACT TO REQUIRE LOCAL GOVERNMENTS TO PUBLISH THE REVENUE-NEUTRAL TAX RATE IN YEARS WHEN THERE IS A GENERAL REVALUATION OF REAL PROPERTY.

OVERVIEW: This act requires counties to state the revenue-neutral property tax rate in their budgets in a year in which a general reappraisal of real property takes place.

FISCAL IMPACT: This act has no fiscal impact.

EFFECTIVE DATE: This act became effective when signed into law by the Governor on June 26, 2003.

ANALYSIS: The amount of property tax due is dependent upon two factors: the property tax rate and the value of the property to which the rate is applied. Property is to be appraised for tax purposes at its true value or market value.[2] To ensure that property is appraised at its true value, the law requires that a county conduct a general reappraisal of real property at least once every eight years.[3] Typically, the value of the tax base increases in revaluation years, especially in urban areas. This increase in value may result in a decreased tax rate, if the county seeks to maintain revenue neutrality with regard to the stream of revenue derived from property taxes.

This act requires a county, in the year in which it conducts a general reappraisal of property, to include in its budget a statement of the revenue-neutral property tax rate for the budget. The revenue-neutral tax rate is the rate that is estimated to produce revenue for the next fiscal year equal to the revenue that would have been produced for the next fiscal year by the current tax rate if no reappraisal had occurred. To calculate the revenue-neutral tax rate, the budget officer must first determine a rate that would produce revenues equal to those produced for the current fiscal year and then increase the rate by a growth factor equal to the average annual percentage increase in the tax base due to improvements since the last general reappraisal. This growth factor should represent the expected percentage increase in the value of the tax base due to improvements during the next fiscal year. The budget officer must further adjust the rate to account for any annexation, deannexation, merger, or similar event.

2003 BUDGET ACT.

Session Law	*Bill #*	*Sponsor*

[2] Agricultural, horticultural, and forestland property, upon proper application, are appraised at present-use value.
[3] G.S. 105-286.

S.L. 2003-284	HB 397	Rep. Crawford, Sherrill (Primary Sponsors)

AN ACT TO APPROPRIATE FUNDS FOR CURRENT OPERATIONS AND CAPITAL IMPROVEMENTS FOR STATE DEPARTMENTS, INSTITUTIONS, AND AGENCIES, AND FOR OTHER PURPOSES, AND TO IMPLEMENT A STATE BUDGET THAT ENABLES THE STATE TO PROVIDE A SUSTAINABLE RECOVERY THROUGH STRONG EDUCATIONAL AND ECONOMIC TOOLS.

OVERVIEW, EFFECTIVE DATES, AND FISCAL IMPACT:

Part #	*Description and Effective Dates*	*Fiscal Impact*
37	**Adjust Local Government Hold-Harmless** Effective June 30, 2003, changed the date that sales tax hold-harmless payments are made to local governments each year, from September 15 to August 15. It also provided that the payments will be made in 2003 and 2004, with intent language for the payments to continue through 2012. This part also provided that the estimates used to calculate the hold-harmless payments must be updated to reflect legislative changes.	No significant fiscal impact on the General Fund in the 2003-05 fiscal biennium.
37-A	**Update Internal Revenue Code Reference and Adjust Bonus Depreciation and Estate Tax** Effective June 30, 2003, changed the State tax law reference to the Internal Revenue Code from January 1, 2003 to June 1, 2003. In May 2003, Congress enacted the Jobs and Growth Tax Relief Reconciliation Act of 2003. That legislation increased from 30% to 50% the bonus depreciation allowance originally enacted in March 2002 in response to the September 11 terrorist attacks and moved the sunset for bonus depreciation from September 10, 2004 to December 31, 2004. In addition, the package increased the amount of investment in capital equipment that a business can expense during the acquisition year (instead of depreciating over many years) from $25,000 to $100,000.	The update in the Code reference fully conforms North Carolina law to the federal expensing limit increase at a cost to the General Fund of $29.2 million in FY 2003-04 and $18.0 million in FY 2004-05. This will reduce state revenues in FY 2003-04 by $40.8 million (due to the increase in bonus depreciation from 30% to 50%) but increase revenues by $18.0 million in FY 2004-05. This provision has no impact for the 2003-04 fiscal year because estates have 9 months

Part #	*Description and Effective Dates*	*Fiscal Impact*
	Continued technical conformity to bonus depreciation so that taxpayers do not have to keep a separate depreciation schedule for State tax purposes for each piece of equipment in addition to the federal schedule. Extended until July 1, 2005, the partial conformity of the State estate tax to changes in the federal estate tax.	after a death to file a return. For FY 2004-05, the proposal saves $70.8 million of General Fund revenue that would have disappeared if the 2002 partial conformity had been allowed to sunset on January 1, 2004.
38	**Temporarily Maintain State Sales Tax Rate** Effective June 30, 2003, extended sunset on the half-cent state sales tax enacted in 2001 from July 1, 2003 to July 1, 2005.	Joint estimates provided by Fiscal Research and the Office of State Management and Budget suggest the following revenue stream from this tax extension. FY 2003-04 $341.7 million FY 2004-05 $388.2 million FY 2005-06 $26.5 million
39	**Temporarily Maintain Upper Income Tax Rate** Effective June 30, 2003, extended the sunset of the 8.25% individual income tax bracket from January 1, 2004 to January 1, 2006.	The additional revenue from this extension is calculated using the North Carolina Individual Income Tax Model. The model estimates that $83.3 million in individual income tax payments will be generated in tax year 2004 and $104.2 million in revenue in tax year 2005. This revenue is divided into fiscal years as follows: FY 2003-2004: $37.5 million FY 2004-2005: $92.7 million FY 2005-2006: $57.3 million
39-B	**Conform Child Tax Credit to Federal Credit** Effective for the 2003 tax year, conformed the State definition of a dependent child to the federal definition for purposes of the individual income tax credit for children.	The change will increase General Fund revenue by $16.8 million in FY 2003-04 and by $17 million in FY 2004-05.
43	**Equalize Insurance Tax Rates on Article 65 Corporations**	This change will increase General Fund revenue by $18.6 million for the 2003-04

Part #	*Description and Effective Dates*	*Fiscal Impact*
	Raised the insurance premiums tax rate on Article 65 corporations from 1.0% to 1.9%, effective for the 2004 tax year. In addition, for the 2004 and 2005 tax years, this act required the affected companies to make estimated tax payments in April and June of each year equal to 50% of the annual liability for that tax year.	fiscal year and $13.9 million for FY 2004-05.
43-A	**Clarify Property Tax Exclusion for Property Used to Reduce Cotton Dust** Clarified a property tax exclusion	No impact on General Fund. No estimate on the fiscal impact on local governments is possible, but the impact is expected to be small.
44	**Continue Use Tax Line Item on Income Tax Form** Effective June 30, 2003, this act extended for two years the law that provides that consumer use tax is payable on the individual income tax return.	This extension will increase General Fund revenue by $3.1 million in both FY 2003-04 and FY 2004-05.
45	**Conform to Streamlined Sales and Use Tax Agreement** This act made numerous changes to the sales and use tax statutes to bring North Carolina into conformity with the Streamlined Sales Tax Agreement. Various effective dates.	The tax on soft drinks will increase sales tax revenues by $41.4 million in FY 2003-04 and by $45.1 million in FY 2004-05. Conversely, the 50% vending machine exemption will reduce sales tax revenue by $4.05 million in FY 2003-04 and $8.6 million in FY 2004-05. The tax on prepared food will increase revenue by $3.05 million in FY 2003-04 and by $3.3 million in FY 2004-05. The candy exemption will reduce revenue by $400,000 in FY 2003-04 and by $800,000 in FY 2004-05.
45-A	**Eliminate Tobacco and Alcohol Discounts** Effective August 1, 2003, eliminated tax reductions that were allowed to distributors and wholesalers who pay the excise taxes on cigarettes and other tobacco products.	The change will increase General Fund revenue by $1.74 million in FY 2003-04 and by $1.9 million in FY 2004-05.

Part #	*Description and Effective Dates*	*Fiscal Impact*
	Effective August 1, 2003, eliminated tax reductions that were allowed to distributors and wholesalers who pay the excise taxes on wine, beer, and spirituous liquor.	The change will increase General Fund revenue by $3.67 million in FY 2003-04 and by $4.0 million in FY 2004-05.
46	**Repairs and Renovations** Effective July 1, 2003, enacts the procedural and regulatory provisions governing the State's issuance of security interest indebtedness. It also provides the specific legislative authorization for up to $300 million of special indebtedness to be used for the repair and renovation of State facilities and related infrastructure.	The expected debt service is $35 million for 2004-05, $32.5 million for 2005-06, and $31.6 million for 2006-07.
46-A	**State Capital Facilities Finance** Effective July 1, 2003, provides specific legislative authorization for three projects: The purchase of two private prisons currently leased by the State. Up to $6,780,000 for the design, construction drawings, and solicitation of bids for three youth development centers. The construction of a structural pest control training facility to be located at NCSU.	The amount of the issuance is to be negotiated. No other fiscal information available. No fiscal information available, in planning stage. No fiscal information available.
47	**Lease-Purchase Three New Prisons** Effective July 1, 2003, provides specific legislative authorization for the lease-purchase of three new prisons.	The cost of constructing the prisons is expected to be between $344 and $364 million. The annual operating cost is expected to be $18 million.

(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2003 Session. Available in the Legislative Library.)

ANALYSIS:

Part 37: Adjust Local Government Hold-Harmless

Part 37 of this act changes the date that sales tax hold-harmless payments are made to local governments each year, from September 15 to August 15. It also provides that the payments will be made in 2003 and 2004 only, but includes intent language for the payments to continue through 2012. The Governor's budget would have eliminated the hold harmless payments beginning in 2003.

In 2001, the General Assembly gave local governments the authority to increase their local sales tax by one-half percent, effective upon the repeal of the State's additional half-percent sales tax on July 1, 2003. Also effective July 1, 2003, the State's reimbursements to local governments were repealed, and the State was directed to provide hold-harmless payments to those local governments whose potential gain from the half-cent local sales tax increase would be less than their loss from the repealed State reimbursements. State reimbursements were for losses due to the repeal of the property tax on inventories and on poultry and livestock, the repeal of the intangibles tax, the "homestead exclusion" from property tax, and the repeal of local sales and use taxes on food purchased with food stamps. In 2002, the General Assembly accelerated the repeal of the State reimbursements from July 1, 2003, to July 1, 2002, and accelerated the effective date that local governments could begin levying the additional half-cent local tax from July 1, 2003, to December 1, 2002.

This part also provides that the estimates used to calculate the hold-harmless payments must be updated to reflect legislative changes.

This part became effective when the act was signed into law by the Governor on June 30, 2003.

Part 37-A: Update Internal Revenue Code Reference And Adjust Bonus Depreciation And Estate Tax

This part makes three changes relating to conformity of State tax laws to federal tax laws. These provisions were not in the House or Senate budgets.

Section 37A.1 of this act updates to June 1, 2003, the date used in defining and determining certain State tax provisions. In May 2003, Congress enacted the Jobs and Growth Tax Relief Reconciliation Act of 2003. That act contained two tax changes that affect federal taxable income, which is the starting point for determining State taxable income, and became effective for the 2003 tax year. The two changes were an increase in the bonus depreciation allowance first enacted after the September 11, 2001, terrorist attacks and an increase in the amount that can be expensed under section 179 of the Internal Revenue Code[4] Section 37A.1 of the act conforms to both of these provisions. Sections 37A.2 and 37A.3 of the act would provide for a bonus depreciation add-back for the 2004 taxable year to offset the second-year losses from the depreciation and expensing provisions.

Sections 37A.4 and 37A.5 delay until July 1, 2005, the phase-out and elimination of the State estate tax that would otherwise occur due to the phase-out and elimination of the federal credit for State death taxes. North Carolina repealed its inheritance tax in 1998, effective for deaths occurring on or after January 1, 1999. It replaced the inheritance tax with an estate tax that is equivalent to the federal state death tax credit allowed on a federal estate tax return. This type of state estate tax is known as a "pick-up" tax because it picks up for the state the amount of federal estate tax that would otherwise be paid to the federal government. In 2001, Congress increased the exclusion amount for the federal estate tax and phased out the state death tax credit over four years by reducing it 25% in 2002, 50% in 2003, and 75% in 2004, and by repealing it entirely in 2005. In 2002, the General Assembly enacted legislation not to conform to the phase-out of the state death tax credit. In other words, the amount of the State estate tax is tied to the federal credit as it existed in 2001 rather than as it currently exists.

[4] Section 179 of the Code allows a taxpayer to treat the cost of certain property as an expense which is not chargeable to a capital account. This allows the taxpayer to take a deduction for the property in the year in which it is placed into service rather than depreciating the property over a number of years.

The 2002 legislation was set to sunset for estates of decedents dying on or after January 1, 2004. This part extends the sunset to July 1, 2005, meaning that the estate tax will continue to be based on the federal credit as it existed in 2001. This part became effective when the act signed into law by the Governor on June 30, 2003.

Part 38: Temporarily Maintain State Sales Tax Rate

Part 38 of this act delays the sunset of the one-half-percent increase in the State sales tax from July 1, 2003, to July 1, 2005. This part became effective when the act was signed into law by the Governor on June 30, 2003. In the 2001 Appropriations Act, S.L. 2001-424, the General Assembly increased the State sales tax by one-half percent, from 4% to 4.5%, effective October 16, 2001. This State sales tax increase was to sunset July 1, 2003. Before 2001, the State sales tax rate had last been increased in 1991 from 3% to 4%.

Part 39: Temporarily Maintain Upper Income Tax Rate

Part 39 of this act delays the sunset of the upper-income individual income tax bracket from January 1, 2004, to January 1, 2006. In 2001, the General Assembly added a new tax bracket that imposed an additional one-half percent income tax (a total rate of 8.25%) on certain North Carolina taxable income for three years. Under prior North Carolina law, tax was imposed at the following rates on individuals' North Carolina taxable income:

Tax Rate	Married filing jointly	Heads of household	Single filers	Married filing separately
6.0%	Up to $21,250	Up to $17,000	Up to $12,750	Up to $10,625
7.0%	Over $21,250 and up to $100,000	Over $17,000 and up to $80,000	Over $12,750 and up to $60,000	Over $10,625 and up to $50,000
7.75%	Over $100,000	Over $80,000	Over $60,000	Over $50,000

The 2001 law created a fourth tax bracket for North Carolina taxable income as follows:

Tax Rate	Married filing jointly	Heads of household	Single filers	Married filing separately
8.25%	Over $200,000	Over $160,000	Over $120,000	Over $100,000

This change was estimated to affect approximately 2% of North Carolina taxpayers. This provision extending the tax rate for two more years was recommended by the Governor.

This part became effective when the act was signed into law by the Governor on June 30, 2003.

Part 39-B: Conform Child Tax Credit To Federal Credit

Part 39-B of this act conforms the State credit for children to the federal definition of whether a dependent child is eligible for the federal credit for dependent children. The effect of this change is to limit the credit to children below 17 years of age. The federal credit is limited to dependent children under age 17 but the North Carolina credit previously applied to 17-year-olds as well as to children over 17 up to age 23 if they are in college. This provision

was part of a provision that was in the Senate budget that would have also delayed the scheduled increase in the credit. This change is effective beginning with the 2003 tax year.

Part 43: Equalize Insurance Tax Rates On Article 65 Corporations

Before 2004, nonprofit medical service corporations, such as Blue Cross/Blue Shield and Delta Dental Corporation, and HMOs paid a gross premiums tax of 1%. Other insurance providers pay a gross premiums tax of 1.9% on most insurance contracts. Companies that pay a gross premiums tax are automatically exempt from corporate income and franchise taxes. This part increases the gross premiums tax rate on medical service corporations from 1% to 1.9% effective January 1, 2004. The tax rate for HMOs (including HMOs directly operated by medical service corporations) remains at 1%.

This part also provides that for the 2004 and 2005 tax years only, medical service corporations will make the following estimated payments of the tax: 50% on April 15 and 50% on June 15, with true-up the following March 15. For subsequent tax years, the general law on installment payments of gross premiums tax will apply. This change accelerates the timing of the tax payment to move the revenue gain to an earlier fiscal year.

This part provides a conditional sunset of the increased tax rate. It requires the Commissioner of Insurance to make a certification to the Department of Revenue and the Revisor of Statutes when there are no longer any medical service corporations that offer anything other than dental service plans. Beginning with the first taxable year after that certification is made, this part will expire and the gross premiums tax rate applied to medical service corporations will revert to 1%. The effect of this provision would be to reduce the rate on medical service corporations if Blue Cross/Blue Shield completes its conversion to for-profit status. In July 2003, Blue Cross/Blue Shield announced its intention not to pursue conversion at this time.

The insurance gross premiums taxes are taxes based on the amount of insurance premiums that are paid or, for certain self-insurers, would have been paid during the year. Before the effective date of this part, they consist of the following:

- A 1.9% tax on most insurance contracts.
- A 1% tax on HMOs and on nonprofit medical service companies, such as Blue Cross/Blue Shield and Delta Dental, that provide hospital, medical, and dental service plans.
- A 2.5% tax on workers' compensation premiums and workers' compensation self-insurers.
- An additional 1.33% tax on premiums for fire and lightening coverage of property other than motor vehicles and boats.
- An additional 0.5% tax on premiums for fire and lightening coverage of property within a fire district.

Part 43-A: Clarify Property Tax Exclusion For Property Used To Reduce Cotton Dust

Part 43A amends the existing property tax exclusion for property exclusively used to reduce or prevent cotton dust in textile plants in accordance with OSHA standards. The new law provides that if parts of a ventilating or air conditioning system are integrated with the cotton dust equipment, the entire system benefits from the tax exclusion, except for the chillers and cooling towers. Because it apparently reflects the previous practice in some counties, the

provision became effective when the act was signed into law by the Governor on June 30, 2003.

Part 44: Continue Use Tax Line Item On Income Tax Form

Part 44 extends for two years the law that provides that consumer use tax is payable on the individual income tax return. The law would otherwise sunset for the 2003 taxable year.

North Carolina has State and local sales and use taxes. The sales tax is paid on purchases made in this State. It is collected by the retailer and remitted to the State. The use tax complements the sales tax by taxing transactions that are not subject to the sales tax because of movement in interstate commerce. The use tax is imposed on the purchaser. Unlike the sales tax, the responsibility for remitting the use tax to the Department of Revenue is also on the purchaser. The 1997 General Assembly established an annual filing period for the payment of use taxes owed by consumers on mail-order and other out-of-state purchases. This change relieved consumers of the duty to file either monthly or quarterly returns.

In 1999, the General Assembly further simplified use tax collection by providing that the use tax will be paid on taxpayers' income tax returns. An individual who owes use tax on nonbusiness purchases and who must remit a State income tax return must pay the use tax with the income tax return. The income tax return has space on it to indicate the amount of use tax owed. Placing the use tax on the individual income tax return, as opposed to a separate use tax return sent to the taxpayer with the income tax return, is intended to increase taxpayers' awareness of their responsibility to pay the tax. In 2000, the General Assembly sunset this provision in anticipation that use tax collection would be handled by retailers by 2003 as a result of the Streamlined Sales Tax Agreement. The 2003 sunset date may have been overly optimistic; this part extends it for two more years. This part became effective when the act was signed into law by the Governor on June 30, 2003.

Part 45: Conform To Streamlined Sales And Use Tax Agreement

In November 2002, the Streamlined Sales Tax implementing states[5] approved a final version of an historic multistate agreement designed to simplify and modernize sales and use tax collection and administration. One objective of the Streamlined Sales and Use Tax Project is to encourage remote vendors to voluntarily collect use tax owed to the states, thereby increasing their collections. A study issued in September 2001 by Bruce and Fox of the University of Tennessee, Knoxville estimated the state and local government revenue loss from sales made through the Internet at $7 billion in 2001 and increasing to $24.2 billion by 2006. The study estimates that North Carolina is currently losing $200 to $300 million a year in uncollected use tax revenues.

A second objective of the Project is to convince Congress or the U.S. Supreme Court to grant collection authority over remote sales to the states that enact the streamlined system embodied in the multistate agreement, on the premise that the system eliminates the burdens on interstate commerce that have been the justification for denying states that authority. If federal legislation is enacted granting states this authority, it is likely to be linked with proposals to extend the Internet Tax Freedom Act moratorium, which expires on November 1, 2003.

To participate in the Streamlines Sales and Use Tax Agreement (Agreement), a state must amend or modify its sales and use tax law to conform to the simplifications and uniformity in the Agreement. The Agreement becomes effective when at least 10 states representing at least

[5] Currently, 40 states plus the District of Columbia are involved in the Streamlined Sales Tax Project. In November 2002, 35 states plus the District of Columbia were involved in the Project.

20% of the total population of all states imposing a state sales tax have petitioned for membership and have been found to be in compliance with the requirements of the Agreement. A certificate of compliance will document each state's compliance with the provisions of the Agreement. As of July 7, 2003, 19 states, with more than 20% of the total population of all states, were in compliance with the Agreement.

Part 45 makes changes to the sales and use tax statutes to bring North Carolina into conformity with the Agreement.

Uniform local sales tax base. – Under the Agreement, all local jurisdictions in a state must have a common tax base. The base for the most recent ½% local sales tax and the ½% Mecklenburg local transit tax does not include food while the other local sales and use taxes do. To conform to the Agreement, the base must be consistent. The State is allowed to tax food at a different rate than its general rate of tax. Section 45.6A of this part finesses the non-uniform local base effective October 1, 2003, by stating that the taxes will be administered as if the local tax on food were zero and the State had a 2% tax on food. This change complies with the Agreement without changing the amount of tax. The State will collect and distribute the 2% local tax on food. Under this act, the distribution with respect to food tax proceeds would have be in proportion to other local sales tax proceeds rather than based on the actual county of collection. This would have resulted in a shifting of revenue among counties, in favor of counties that are retail centers. However, this part was amended by Section 27 of S.L. 2003-416. Half of these proceeds will now be distributed based on population with the remaining half being distributed based on the proportion of sales taxes on food collected under Article 39 of Chapter 105 of the General Statutes within the county in the 1997-98 fiscal year in relation to the total collections under that Article.

Candy, soft drinks, and prepared food. – Under the Agreement, if there is a uniform definition for a type of product, a state may not exempt only part of the items included in the definition. Candy, soft drinks, and prepared foods have uniform definitions in the Agreement. Under previous law, North Carolina exempted those items as food only to the extent they were purchased for home consumption. To conform to the Agreement, the products must be treated consistently whether or not they are intended for home consumption. This part removed soft drinks and prepared foods from the exemption for food effective July 15, 2003. It offsets the impact of this change by extending to vending machine soft drinks the 50% sales tax reduction currently allowed to other products sold in vending machines, effective January 1, 2004. This part exempts all candy as if it were food, effective January 1, 2004.

Definitions. – The Agreement mandates that a state that uses any of the terms defined in the Agreement in its sales and use tax laws must define the terms in substantially the same language as the Agreement uses. To conform to the Agreement, this part modifies and defines the following terms: computer, computer software, custom computer software, prewritten computer software, delivered electronically, load and leave, direct mail, drug, durable medical equipment, durable medical supplies, electronic, lease or rental, mobility enhancing equipment, over-the-counter drug, prepared food, prescription, prosthetic device, and tangible personal property. This provision became effective July 15, 2003.

Modifications to prewritten software. – As discussed above, the Agreement mandates that a state must either tax or exempt all products within a given uniform definition. Previously, North Carolina taxed prewritten computer software that had not been modified and it exempted both custom computer software and prewritten computer software that had been modified. To conform to the Agreement, the State will tax the prewritten portion of modified computer software and it will exempt the modifications to it if the charges for the modifications are

separately stated. Through the use of defined terms, computer software that is delivered electronically or by "load and leave" will remain exempt from tax. This provision became effective July 15, 2003.

Mobility enhancing equipment. – To provide consistent treatment of products within a uniform definition, this part provides that mobility enhancing equipment must be sold on a prescription to be exempt from tax. Under previous law, a few items that come within this defined term, such as crutches, did not need to be sold on a prescription to be exempt. However, to preserve the previous tax treatment as much as possible, this part requires mobility enhancing equipment to be sold on a prescription in order to be exempt since previous law required most items in this category to be sold on prescription in order to be exempt. This provision became effective July 15, 2003.

Uniform sourcing rules. – North Carolina adopted many of the uniform sourcing principles in 2001. This part codifies additional sourcing principles for periodic rental payments. The codified principles reflect previous practice. This provision became effective July 15, 2003.

Uniform returns and remittances and notices. – North Carolina adopted many of the uniform provisions governing returns, remittances, and notices in 2001. This part adds a few more provisions:

- The collection period for a seller that collects less than $1,000 in State sales tax during a calendar year cannot be more often than annually. This provision became effective October 1, 2003.
- Monthly returns are due by the 20th day of the month, instead of the 15th day of the month. This provision became effective October 1, 2003.
- Catalog sellers must be given at least 120 days' notice of tax changes and tax rate changes. This provision became effective July 15, 2003.

Sales tax holiday. – The Agreement sets forth certain conditions that sales tax holidays must meet after December 31, 2003. One of the conditions is that the items to be exempt must be specifically defined in the Agreement. North Carolina's sales tax holiday exempts printers, printer supplies, educational computer software, and school supplies. None of these terms are defined in the Agreement. The implementing states are currently working on a definition of "school supplies". This act makes the following changes to the Sales Tax Holiday effective October 1, 2003: It removes printers, printer supplies, and educational computer software from the exemption. It also extends the exemption to layaway sales.

In addition to the sales and use tax modifications made by this part, North Carolina will need to address the following issue in the near future to remain in conformity with the Agreement:

Multiple rates, caps, and thresholds. – The Agreement mandates the elimination of caps and thresholds under most circumstances after December 31, 2005. It also mandates a single tax rate per taxing jurisdiction after December 31, 2005. North Carolina currently has a 1% tax rate on certain items and a 1% rate with a $80 cap on some other items. It has a 3% rate with a $1,500 cap on mobile classrooms and offices. It also has a different rate on telecommunications, satellite TV, and spirituous liquor and it has a $1,500 threshold for the sales tax applicable to funeral expenses.

Part 45-A: Eliminate Tobacco And Alcohol Discounts

Part 45A of this act eliminates tax reductions that were previously allowed to distributors and wholesalers who pay the excise taxes on cigarettes, other tobacco products, wine, beer, and

spirituous liquor. These discounts were equal to 4% of the tax due. The cigarette and tobacco discounts were intended to cover expenses incurred in preparing tax reports and the expense of furnishing a bond. The discounts for alcoholic beverages are intended to cover these expenses and also losses due to spoilage or breakage. This part became effective August 1, 2003.

An amendment to House Bill 1303 would have partially restored these discounts. On July 19, 2003, the Senate passed an amendment that would have reinstated these discounts at a rate of 2% rather than 4%. That bill then passed the Senate and was sent to the House for concurrence. The House adjourned without voting on concurrence.

Part 46: Repairs And Renovations

Part 46 enacts the procedural and regulatory provisions governing the State's issuance of security interest indebtedness by creating the "State Capital Facilities Financing Act".[6] Security interest indebtedness, commonly referred to as "certificates of participation", is debt that is secured by an interest in the property being financed, repaired, or renovated. Since the property serves as the security for the indebtedness, there is no pledge of the State's faith and credit or taxing power. Thus, voter approval is not necessary for the borrowing. If the State defaulted on its repayments, no deficiency judgment could be rendered against the State, but the capital facilities that serve as security could be disposed of to generate funds to satisfy the debt. The State could choose not to appropriate funds to repay the debt, but such a decision would have negative consequences for the State's credit rating.

The Act uses the term "special indebtedness" to cover the three forms that this type of debt can take: installment purchase (with or without certificates of participation), lease-purchase (with or without certificates of participation), and limited obligation bonds. The particular form to be used for a given project will depend on its size, the nature of the property and the improvement, and other circumstances. Based on these circumstances, one form or another of security interest debt may be the least expensive and most practical for the State to utilize. (*For a more extensive summary of the "State Capital Facilities Financing Act", see the summary for S.L. 2003-314.*)

Part 46 also provides the specific legislative authorization for up to $300 million of special indebtedness to be used for the repair and renovation of State facilities and related infrastructure that are supported from the General Fund. The proceeds of the obligations would be used to repair and renovate State buildings in the same manner as funds in the Reserve for Repair and Renovations are used. Funds in that Reserve may be used for structural and roof repairs, repairs to heating, air conditioning and related equipment, repairs needed for health and safety or to comply with standards imposed by law, and repairs for energy efficiency and to improve the usage of space. Funds may not be used for new buildings or to increase the footprint of a building unless required to comply with standards imposed by law. Except in the case of an emergency, the Director of the Budget is required to consult with the Joint Legislative Commission on Governmental Operations before incurring debt for specific repair and renovation projects.

Part 31.5 of this act modifies how the funds in the Repairs and Renovations Reserve Account can be used for the 2003-04 fiscal year; it did not amend G.S. 143-15.3A, the statute that governs the Reserve Account. Under Part 31.5, 46% of the funds in the Reserve for the 2003-04 fiscal year is allocated to the Board of Governors of The University of North Carolina for repairs and

[6] This act rewrites the "State Capital Facilities Financing Act" contained in S.L. 2003-314. In that legislation, the procedural and regulatory provisions applied only to the financing of a new psychiatric hospital.

renovations and the remaining 54% is allocated to the Office of State Budget and Management. Notwithstanding G.S. 143-15.3A, Part 31.5 provides that the Board of Governors may use the funds allocated to it for repairs and renovation of facilities not supported by the General Fund if the Board determines that sufficient funds are not available from other sources and that conditions warrant General Fund assistance. Part 31.5 also provides that the Office of State Budget and Management can use the funds allocated to it during the 2003-04 fiscal year to complete the construction of State-owned facilities that are partially completed.

The bond proceeds authorized to be issued by this Part will not go directly into the Repairs and Renovations Reserve Account; they will go into a trust account and, according to this Part, be used "for the purposes and in accordance with the procedures provided in G.S. 143-15.3A". Because the modifications made by Part 31.5 of this act to the purposes for which the funds in the Reserve Account could be used were not made to the statute itself, it is unclear whether the bond proceeds authorized by this Part may be used in accordance with the modifications made by Part 31.5 of this act. Section 98 of the technical corrections bill, House Bill 281, 6th edition, sought to clarify this issue by providing that the debt issued during the 2003-04 fiscal year for repairs and renovations be spent in accordance with the modifications to G.S. 143-15.3A made by Part 31.5 of this act. However, the General Assembly did not enact House Bill 281.

Part 46-A: State Capital Facilities Finance

Part 46A authorizes the State to incur security interest indebtedness for three projects. The first is to purchase two private prisons currently being leased and operated by the State.[7] The Office of the State Treasurer estimates that the annual debt payments will be lower than the annual lease payments. The Treasurer's Office has been advised by bond counsel that under the terms of the lease it may be possible to purchase these prisons during the 2003-2004 fiscal year, possibly during the first six months of the fiscal year. For that reason, the bond counsel advised that the authorization be included within the budget for the upcoming fiscal year. The provision states that the amount that the Department of Correction would otherwise pay for property taxes on the facilities during the 2004-2005 biennium will be paid to the counties in lieu thereof if the purchase is made at a time that will result in no taxes being due for either year of the biennium.

Second, Part 46A authorizes the State to incur up to $6,780,000 in security interest indebtedness for design, construction drawings, and solicitation of bids for construction of three youth development centers to be operated by the Department of Juvenile Justice and Delinquency Prevention and for infrastructure and site work at one of the three centers. The Office of State Construction will manage the design process. Section 15.7 of this act allows the Department for Juvenile Justice and Delinquency Prevention to continue planning for the new centers but requires a quarterly status report on the planning and design to the JPS Appropriations Chairs and the Joint Legislative Corrections, Crime Control, and Juvenile Justice Oversight Committee. The design phase should be completed by April 15, 2004, and a final report should be issued that includes the anticipated total cost of each proposed center and the recommended locations.

Third, Part 46A authorizes the State to incur security interest indebtedness for the construction of a structural pest control training facility to be located at North Carolina State University.

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[7] Pamlico County Correctional Facility and the Mountain View Correctional Facility located in Avery County. The prisons are owned by a private vendor and were originally operated by the vendor.

Part 47: Lease-Purchase Three New Prisons

Part 47 would authorize the State to enter into lease-purchase contracts to build three new prisons. In 2001, the General Assembly authorized lease-purchase financing of three new 1000-cell close security prisons. Section 47.1 would authorize three more substantially identical prisons. Section 47.2 provides that if construction begins before January 1, 2004, and the plans have been approved by the Department of Insurance, the 1996-1999 version of the Building Code applies to the first two of the three prisons.

The State may first try to negotiate a contract for these new prisons with the same company that is building the 2001 prisons. If the Secretary of Administration and the Council of State find that the negotiations have failed to produce a reasonable price, the State would solicit proposals for the projects using a similar procedure as for the 2001 prisons. Unlike with the 2001 prisons, the initial construction loan will not be obtained by the vendor on a private, taxable basis. The entire cost, including construction, will be financed by the State with tax-exempt obligations. The prisons are exempt from property taxes both during and after construction.

Part 47 provides that a nonprofit corporation controlled by the State will work with the Department of Correction to contract directly with the construction contractor for construction of the prisons and will lease the prisons to the State under a lease-purchase agreement. The nonprofit corporation would finance the costs by selling tax-exempt obligations known as certificates of participation (COPs). The COPs would represent interests in the nonprofit corporation's rights to receive the lease payments under the lease-purchase agreement with the State. The COPs would be secured by a lien on the property, not by a pledge of the State's full faith and credit. The COPs would be paid from the State's lease-purchase payments over the course of 20 years.

Because the construction contract is technically between a private, nonprofit corporation and the construction contractor, the Attorney General's Office has determined that requirements for public bidding of construction would not apply. The new prisons are to be substantially identical to the 2001 prisons, so the State and the nonprofit corporation will first try to negotiate a contract with the existing construction contractor to build the new prisons. If, in the opinion of the Secretary of Administration and the Council of State, the terms of the proposed negotiated contract are not favorable to the State, the Department of Correction will solicit for the construction of the new prisons. In this situation, the Department of Correction would be required to consult with the Joint Legislative Commission on Governmental Operations before making a final award decision. The final award decision would also be subject to the approval of the Council of State.

The prisons would be required to be built in accordance with plans and specifications developed by the Department of Correction, and the Department of Correction and the State Construction Office would inspect and review the facilities during construction to ensure that they are suitable for use and acquisition by the State. The minority participation requirements of G.S. 143-128.2 apply to these projects.

The lease-purchase agreement would be between the nonprofit corporation and the State. Under the agreement, which must be approved by the Council of State and the State Treasurer, the State would make lease-purchase payments to the nonprofit corporation, which would use the funds to retire the COPs. The COPs would be secured by a lien on the property and the State's failure to make payments could result in its eviction from the property. The State Treasurer would determine the price to be paid for the COPs and the rate of interest to be

paid on them. The State would retain the option of refinancing the debt if interest rates fall. The State would also retain the option of paying off its obligations and purchasing the property before the end of the lease-purchase period. Under the lease-purchase agreement, the State will own the facilities at the end of the lease term. The nonprofit corporation that issues the COPs would be subject to the Public Records Act and the Open Meetings Law.

WAIVE DEADLINES FOR TROOPS.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-300	**SB 936**	**Senator Kerr**

AN ACT TO WAIVE VARIOUS DEADLINES, FEES, AND PENALTIES FOR DEPLOYED MILITARY PERSONNEL.

OVERVIEW: This act provides assistance to military personnel called to active duty in support of Operation Iraqi Freedom on or after January 1, 2003 as follows:

- Authorizes the Governor to allow military personnel 90 days from the end of their deployment to renew their driver's license, renew their motor vehicle liability insurance, or renew an occupational license.
- Allows military personnel 90 days from the end of their deployment to pay current year's property taxes or list property for next year's property taxes.
- Authorizes the Governor to waive civil penalties and restoration fees for military personnel whose motor vehicle liability insurance lapsed during the period of deployment or within 90 days after the member returned to North Carolina if the member certifies that the motor vehicle was not driven during the period in which the vehicle was uninsured and that the vehicle is now insured.
- Directs community colleges to grant full refunds of tuition to military reserve and National Guard personnel called to active duty and to active personnel, who because of their reassignments, are unable to complete courses. The community colleges must buy back textbooks to the extent possible.
- Authorizes the constituent institutions of The University of North Carolina to issue refunds of tuition and required fees and to determine whether to give full or pro rata refunds of housing, parking and other optional fees to students to whom they give tuition and required fee refunds. The refunds may be issued to students who are involuntarily called to active duty, who volunteer for military service, or who withdraw because of circumstances related to a national emergency.
- Waives repayment of the North Carolina Legislative Tuition Grant for any semester that the student loses full-time student status due to a call to active military duty.

FISCAL IMPACT: The act does not affect the State General Fund, but it may delay revenue collection in the 2003-2004 fiscal year for driver's licenses (Highway Fund), occupational licenses (Licensing Board Special Accounts), and property tax collections (local governments). It is not possible to estimate this temporary fiscal impact, because the General Assembly's Fiscal Research Division does not have access to records of military personnel assigned to Operation Iraqi Freedom. Even if such records were accessible, the Division could not easily match driver

records, local tax records, and occupational license records to military personnel. *(For a more complete fiscal analysis, see the Overview: Fiscal and Budgetary Actions, 2003 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective when signed into law by the Governor on July 4, 2003.

ANALYSIS: This act provides relief to deployed military personnel by extending certain deadlines, waiving penalties and fees, and allowing tuition refunds. The term "deployed military personnel" is defined as a member of any of the following that are on active duty in support of Operation Iraqi Freedom on or after January 1, 2003:

- Armed forces or armed forces reserves of the United States.
- The North Carolina Army National Guard or the North Carolina Air National Guard, but only if called to active duty in support of the Operation on or after January 1, 2003.

Verification by the military member's command specifying deployment is conclusive evidence of the soldier's deployment.

Extend Deadlines and Waive Penalties and Fees

The act allows the Governor to extend deadlines and waive penalties and fees for deployed military personnel. These extensions and waivers include the following:

- Extend for up to 90 days from the end of deployment the validity of a driver's license or temporary driver's license.[8]
- Extend for up to 90 days the validity of an occupational license and allow for the prorating of any renewal fee associated with an occupational license.[9]
- Waive any civil penalty and restoration fees associated with motor vehicle liability lapses if the soldier certifies that the motor vehicle was not driven during the period in which the vehicle was insured and that the vehicle is now insured. The Division of Motor Vehicles already has policies and procedures in place to handle military personnel on a case-by-case basis. Fines, penalties, and revocations are waived if a person is deployed or unable to handle his or her business due to military actions.

Extend Property Tax Listing and Payment

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[8] S.L. 2003-152 establishes a military designation for a driver's license issued to a person on active duty and to the person's spouse and dependent children. The military designation allows the holder of the license to renew by mail no more than two times during the holder's lifetime. A license renewed by mail is considered a permanent license and does not expire when the holder returns to the State. The military designation also allows the person on active duty to renew the license up to one year prior to its expiration. A license holder who is serving in a combat zone or a qualified hazardous duty zone may renew by mail without having to take an eye exam.

[9] Section 3 of the act refers to the definition of "occupational license" as defined in G.S. 93B-1. Although that definition does not specifically preclude occupational licenses issued by State agencies, such as a license to sell insurance, the term "occupational licensing board" in G.S. 93B-1 specifically excludes State agencies. House Bill 281 would have amended this portion of the act to clarify that the authority of the Governor to extend the validity of occupational licenses for deployed military personnel includes occupational licenses issued by a State agency. House Bill 281 was sent to a conference committee but was never ratified.

The act extends property tax deadlines for deployed military personnel by allowing them 90 days after the end of their deployment to pay property taxes that become due or delinquent during the deployment. If the taxes are paid within this 90-day period, no interest is due. The act also provides that deployed military personnel are allowed 90 days after the end of their deployment to list for taxation property that was otherwise required to be listed during their deployment. If the property is listed within this 90-day period, no penalties for failure to list apply.[10]

Refund Community College and UNC System Tuition and Fees

The act requires community colleges to grant a full refund of tuition and fees to deployed military reserve and national guard personnel who request a refund because their deployment makes it impossible to complete course requirements. The community colleges must also buy back textbooks to the extent possible and use distance-learning technologies to help these students complete their course requirements. This section of the act applies to the 2002-2003 and 2003-2004 academic years only.

The act authorizes the constituent institutions of The University of North Carolina to grant a full refund of tuition and required fees to students who request a refund because of involuntary or voluntary service in the military or because of circumstances related to national emergencies. The constituent institutions should determine whether to give full or pro rata refunds of housing, parking, and other optional fees to students to whom they give tuition and required fee refunds. The act recommends that every campus review its policy on tuition refunds and make modifications to cover the circumstances described in the act.

Legislation similar to this part of the act was enacted for military personnel deployed or called to active duty during Operation Desert Storm, S.L. 1991-160, and during Operation Enduring Freedom and Noble Eagle, S.L. 2001-508. As a result of the 2001 legislation, the State Board of Community Colleges and the UNC System now have policies on refunds of tuition and fees. The State Board of Community Colleges authorized the initiation of the rule-making process to make permanent military tuition refunds when students are unable to complete their course requirements because they were called to active duty in September 2001.[11] Effective October 12, 2001, the UNC Policy Manual has guidelines for refunds of tuition and fees for students requesting refunds due to military service or national emergencies.[12]

Waive Legislative Tuition Grants

The act waives repayment of the North Carolina Tuition Grant by students who lose their full-time student status due to active military duty or circumstances related to national emergencies. This section of the act applies to the 2002-2003 and 2003-2004 academic years only.

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[10] Under G.S. 105-360, property taxes are due September 1 of the fiscal year, and interest begins to accrue on the taxes on or after January 6 following the due date. Under G.S. 105-307, the regular listing period for property taxes ends on January 31.

[11] 23 NCAC 02D.0202(f) and 23 NCAC 02D.0203(e). The wording of this rule is almost verbatim the language in Sections 5(a) and (b) of the act.

[12] The wording of the policy is almost verbatim the language in Section 6(a) of the act.

PSYCHIATRIC HOSPITAL FINANCING.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-314, as amended by S.L. 2003-284	**HB 684**	**Rep. Crawford, G. Allen, Fox, Luebke (Primary Sponsors)**

AN ACT TO PROVIDE FOR FINANCING THE CONSTRUCTION OF A NEW PSYCHIATRIC HOSPITAL TO BE LOCATED IN BUTNER.

OVERVIEW: This act, as rewritten by S.L. 2003-284, authorizes the issuance of up to $110 million in security interest debt to finance the acquisition, construction, and equipping of an approximately 450,000 square foot, 432-bed new psychiatric hospital to be located in Butner. The act also enacts the procedural and regulatory provisions governing the State's issuance of security interest indebtedness by creating the "State Capital Facilities Financing Act".[13] Security interest indebtedness is debt that is secured by an interest in the property being financed, repaired, or renovated. The act uses the term "special indebtedness" to cover the three forms that this type of debt can take: installment purchase, lease-purchase, and bonds. In each case, the debt is non-voted.

FISCAL IMPACT: Debt service for the construction of the new psychiatric hospital is anticipated to cost the State from $12.1 million to $5.83 million a year. It is anticipated that the cost savings from the closure of both Dorothea Dix Hospital and John Umstead Hospital will be sufficient to offset the cost of these debt service payments. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2003 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The act became effective when signed into law by the Governor on July 10, 2003. S.L. 2003-284 became effective June 30, 2003. Therefore, the limited scope of the State Capital Facilities Financing Act as enacted by this act was superseded from the beginning by the broader rewrite of the Act in S.L. 2003-284.

ANALYSIS: The North Carolina Constitution[14] and the North Carolina General Statutes restrict the General Assembly's authority to issue debt. Except in limited circumstances, [15] the

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[13] The bill as enacted provided procedural and regulatory provisions only for security interest indebtedness for the psychiatric hospital. The Current Operations and Capital Improvements Appropriations Act of 2003, S.L. 2003-284, rewrote this act to extend the procedural and regulatory framework to any State security interest indebtedness. Under S.L. 2003-284, the State may employ security interest indebtedness for the following projects: $300,000,000 for repairs and renovations of State facilities and related infrastructure that are supported from the General Fund; the acquisition of two private prisons in Pamlico and Avery Counties; $6,780,000 for the design and planning of three youth development centers; $310,000 for a structural pest control training facility at North Carolina State University; and the lease purchase of three new prisons.

[14] Article V, Sec. 3 of the North Carolina Constitution.

[15] The North Carolina Constitution allows the General Assembly to issue non-voted general obligation bonds in an amount not to exceed 2/3 of the amount by which it reduced its outstanding general obligation debt in the preceding biennium. Other Constitutional exceptions for non-voted general obligation debt include the following: to fund or refund an existing debt; to supply an unforeseen deficiency in the revenue; to borrow in anticipation of the collection of taxes due and payable within the current fiscal year to an amount not exceeding 50% of the taxes due; to suppress riots or

General Assembly does not have the power to authorize the issuance of bonds secured by a pledge of the faith and credit of the State without a referendum approved by a majority of the voters voting in an election. These bonds are referred to as general obligation bonds because the general taxing power of the State secures the bonds. Article 5 of Chapter 159 of the General Statutes authorizes the State to use revenue bonds to finance a project without voter approval, but authorization by specific legislation is required under G.S. 159-88(c). Revenue bonds involve the pledge of non-tax revenues related to the project, such as parking fees for parking decks and water and sewer charges for water and sewer projects. In recent years, the State has used security interest indebtedness as a financing tool on a project-by-project basis.[16] This act provides the procedural and regulatory provisions needed to carry out security interest indebtedness. As with revenue bonds, authorization to use security interest indebtedness must be given by the General Assembly through specific legislation under G.S. 142-83, as enacted by this act.

Security interest indebtedness is commonly referred to as "certificates of participation". The act employs the term "special indebtedness" to cover the three forms that this type of debt can take: installment purchase (with or without certificates of participation), lease-purchase (with or without certificates of participation), and limited obligation bonds. In each case, the debt is non-voted. The particular form to be used for a given project[17] will depend on its size, the nature of the property and the improvement, and other circumstances. Based on these circumstances, one form or another of security interest debt may be the least expensive and most practical for the State to utilize.

Under security interest indebtedness, the debt is secured by a lien on or security interest in all or any part of the capital facilities to be financed, including all or part of any land on which improvements are to be constructed. If the project is a renovation, the entire existing facility as well as the improvement could serve as security. The value of the property securing the debt may exceed the amount of the debt and the financing of several capital projects may be jointly secured by liens on some or all of the capital facilities being financed.

Because the property serves as the security for the indebtedness, there would be no pledge of the State's faith and credit or taxing power. Thus, voter approval is not necessary for the borrowing. If the State defaulted on its repayments, no deficiency judgment could be rendered against the State, but the capital facilities that serve as security could be disposed of to generate funds to satisfy the debt. The State could choose not to appropriate funds to repay the debt, but such a decision would have negative consequences for the State's credit rating.

Before special indebtedness can be issued or incurred, the State Treasurer must certify that debt financing may be desirable for a specific project presented to it by the Department of

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insurrections, or to repel invasions; and to meet emergencies immediately threatening the public health or safety, as conclusively determined in writing by the Governor.

[16] S.L. 2000-143 authorized installment contract financing for a $13.5 million office building and wildlife education center for the Wildlife Commission and a $4 million Eastern Wildlife Education Center. S.L. 2001-84 authorized the State to enter into lease-purchase contracts to finance three prisons. S. L. 2002-161 authorized installment-financing contracts for guaranteed energy savings contracts for State buildings.

[17] The Act specifically defines the capital expenditures that may be financed as any combination of buildings, utilities, structures, and other facilities and property developments, including streets, landscaping, equipment and furnishing in connection with a building project; additions, renovations, and improvements to existing facilities; land acquisition; infrastructure; and furniture, equipment, vehicles, machinery, and similar items.

Administration. Next, the Council of State must give preliminary approval. If preliminary approval is obtained, the Council of State must give final approval, setting out details such as the maximum amount to be financed, the maximum maturity, and the maximum interest rates. The maximum maturity may not exceed 40 years. The State Treasurer must approve the financing, finding that the amount to be borrowed is adequate and not excessive and will not require an excessive increase in any State revenues to provide for repayment, and that the special indebtedness can be incurred or issued on terms favorable to the State. Finally, the State Treasurer must report to the Joint Legislative Commission on Governmental Operations at least five days before any special indebtedness is issued or incurred.

Once it is determined that special indebtedness can be issued or incurred, the funds can be borrowed from a single entity in an installment purchase or lease purchase contract, generated by the issuance of limited obligation bonds, or borrowed under an installment financing contract by the sale of certificates of participation. A certificate of participation represents the holder's undivided interest in the right to receive the installment payments to be made by the State. If certificates of participation are issued, a nonprofit corporation will act as a straw person to facilitate the financing.

This act not only provides the statutory framework for special indebtedness as a financing tool of the State, but also provides the specific legislative authorization for up to $110 million of this type of indebtedness to be used for a new psychiatric hospital to be located in Butner. The new facility will consist of approximately 450,000 square feet and contain 432 beds. The indebtedness for this project cannot be incurred prior to July 1, 2004.

The new psychiatric hospital to be built in Butner will replace the current John Umstead Hospital in Butner and Dorothea Dix Hospital in Raleigh. These two psychiatric hospitals are outdated facilities that need extensive repairs and renovations. Even with significant repairs and renovations, the Secretary of Health and Human Services says that they would still be unable to support the latest mental health treatments. The Secretary believes that replacing the two hospitals with one regional facility will save an estimated $40.9 million a year by reducing costs. The act directs that any nonrecurring savings in State appropriations realized from the closure of the two current facilities that are in excess of the cost of operating and maintaining the new hospital will be credited to the Trust Fund for Mental Health, Developmental Disabilities, and Substance Abuse Services and Bridge Funding Needs. The act also directs that any recurring savings realized from the closure of the existing two hospitals shall be used for the payment of debt service on financing contract indebtedness for the construction of the new hospital. The act provides that the State Treasurer may require one or more reports evidencing the savings expected to be realized from the closure of existing psychiatric hospitals that are to be replaced by the project and the feasibility of the financing of the project.

The act also makes the following changes:

- Requires DHHS to maintain research programs currently being conducted at Dorothea Dix hospital and John Umstead hospital by the UNC Medical School and the UNC-Chapel Hill Psychology Department.
- Authorizes the county chosen as the site for the hospital to acquire the land by eminent domain and to convey the land to the State.
- Creates a study commission to consider the potential disposition of the State-owned real property encompassing the Dorothea Dix Hospital campus. The Dorothea Dix Hospital Property Study Commission must make recommendations on the options for sale of the

property to the Joint Legislative Commission on Governmental Operations before any part of the property may be sold to a nongovernmental entity.

WATER & SEWER AUTHORITY SETOFF.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-333	**SB 529**	**Senator Hartsell**

AN ACT TO AUTHORIZE WATER AND SEWER AUTHORITIES TO USE THE SETOFF DEBT COLLECTION ACT.

OVERVIEW: This act adds water and sewer authorities to the list of local governments allowed to submit debts to the Department of Revenue for collection under the Setoff Debt Collection Act.

FISCAL IMPACT: This act has no impact on the State General Fund, and any fiscal impact on water and sewer authorities cannot be determined.

EFFECTIVE DATE: This act is effective January 1, 2004, and applies to income tax refunds determined on or after that date.

ANALYSIS: The act adds water and sewer authorities to the Setoff Debt Collection Act, under which the Department of Revenue diverts part or all of an individual's income tax refund to pay a debt the individual owes to a State or local agency.[18] Thus, the debt the individual owes the agency is set off against the individual's income tax refund. Before January 1, 2000, the setoff program was open only to State agencies.[19] Now, counties and municipalities participate through a clearinghouse that submits debts on their behalf to the Department of Revenue. The clearinghouse was established pursuant to an interlocal agreement adopted under Article 20 of Chapter 160A of the General Statutes. Because there are so many local agencies, funneling their claims through a clearinghouse avoids placing an undue administrative burden on the Department of Revenue.

The act allows water and sewer authorities to participate in the setoff program through the clearinghouse in the same manner as counties and cities. Like counties and cities, a water and sewer authority will be authorized to submit its debts for collection by setoff only after providing the debtor with notice, an opportunity to be heard before the water and sewer authority, and an appeal process under the Administrative Procedure Act.

The creation of a water and sewer authority is one mechanism a county and city can use to address water and sewer needs. One or more counties, cities, sanitary districts, and other political subdivisions may create a water and sewer authority by adopting resolutions stating their intent to do so.[20] Each resolution must be adopted after notice is published and a public hearing is held on the issue. A political subdivision can withdraw from the authority at any time

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[18] The Setoff Debt Collection Act applies only to a debt that is at least $50 and to a refund that is at least $50. Debts collected through the Setoff Debt Collection Act are subject to both a State collection assistance fee and a local collection assistance fee. The amount of the local fee is $15. The amount of the State collection assistance fee is based on the Department's actual cost of collection debts under the Act during the preceding year. The current amount of that fee is $4.32.

[19] S.L. 1997-490.

[20] In certain circumstances, a nonprofit water company may also be a part of a water and sewer authority. See G.S. 162A-3.

before obligations of the authority have been incurred. A water and sewer authority may issue revenue bonds; enter into installment finance contracts; impose rates, fees, and charges; and levy special assessments. Water and sewer authorities may also apply for grants from the Clean Water Revolving Loan and Grant Fund.

Currently there are fewer than a dozen water and sewer authorities in the State. A water and sewer authority may discontinue services to a customer whose account is delinquent for 30 days or more. However, this remedy is not sufficient when the customer moves out of the authority's service district or when the amount due is large enough that discontinuing the service would not result in the payment of the amount due.

REVENUE ADMINISTRATIVE CHANGES.

Session Law	Bill #	Sponsor
S.L. 2003-349	**SB 236**	**Senator Kerr**

AN ACT TO MODIFY THE DIVIDEND RECEIVED DEDUCTION FOR REGULATED INVESTMENT COMPANIES AND REAL ESTATE INVESTMENT TRUSTS TO ENSURE THAT ALL DIVIDENDS ARE TREATED UNIFORMLY, TO EXTEND FOR TWO YEARS THE DEPARTMENT OF REVENUE'S AUTHORITY TO OUTSOURCE THE COLLECTION OF IN-STATE TAX DEBTS, TO AMEND THE MOTOR FUEL TAX LAWS, AND TO MAKE VARIOUS ADMINISTRATIVE CHANGES IN THE TAX LAWS.

OVERVIEW: This act makes the following changes:

- It modifies the dividends received deduction for regulated investment companies and real estate investment trusts to ensure that all dividends are treated uniformly, effective for taxable years beginning on or after January 1, 2003, as recommended by the Revenue Laws Study Committee.
- It amends the reporting requirements regarding sales of seized property by the Secretary of Revenue to avoid duplicative filing of reports, as recommended by the Revenue Laws Study Committee.
- It extends until October 1, 2005, the Department of Revenue's authority to continue using private collection agencies for the collection of in-state tax debts, as recommended by the Revenue Laws Study Committee.
- It revises the secrecy provision regarding the disclosure of tax information to reflect the transfer of certain functions and personnel from the Division of Motor Vehicles to the Division of the State Highway Patrol of the Department of Crime Control and Public Safety, as recommended by the Revenue Laws Study Committee.
- It ensures that the monthly distribution of local sales and use tax proceeds is based on taxpayer data from filed returns, effective July 1, 2003, as recommended by the Revenue Laws Study Committee.
- It simplifies the process for making the local sales tax hold-harmless calculation by requiring the Department of Revenue, rather than the Office of State Budget and Management, to make the required projection of estimated tax proceeds, as recommended by the Revenue Laws Study Committee.

- It clarifies that the $20 filing fee for corporate annual reports is nonrefundable, as recommended by the Revenue Laws Study Committee.
- It clarifies the Research and Development tax credit, as requested by the Department of Commerce and the Department of Revenue.
- It directs the Revenue Laws Study Committee to form a group of tax professionals to work with the Department of Revenue to gather appropriate data to support an estimate of the fiscal impact of allowing corporations to file consolidated tax returns.
- It makes various changes to the motor fuel laws, as requested by the Motor Fuels Tax Division of the Department of Revenue. These changes include technical changes, conforming changes, and substantive changes.
- It codifies the administrative practice of allowing municipalities that sell electricity to exempt from their gross receipts for sales tax purposes those customer accounts that have been determined to be worthless. The sales tax law clearly allows this exemption for other taxpayers.

FISCAL IMPACT: This act has no impact on the General Fund. Part 10 of this act is expected to affect the Highway Fund and other funds, as described in the analysis of Part 10, below. *(For a more complete fiscal analysis, see the Overview: Fiscal and Budgetary Actions, 2003 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: See Analysis.

ANALYSIS:

Part 1: Modify Dividends Received Deduction for RICs and REITs

Part 1 of this act repeals the dividend deduction provisions that previously applied to regulated investment companies (RICs) and real estate investment trusts (REITs), effective beginning with the 2003 tax year. The effect of the repeal is to conform to the federal dividend deduction for RICs and to the federal disallowance of any dividend deduction for REITs.

The federal dividends received deduction[21] is meant to reduce the negative effects of the double tax on C corporation profits distributed as dividends to corporate shareholders. Subject to certain exceptions and limitations, corporations may deduct 70% of the dividends received from another domestic corporation if the receiving corporation owns less than 20% of the distributing corporation. The deduction rises to 80% of dividends if the corporation owns 20% or more of the corporation paying the dividends, and to 100% if the corporations are "affiliated" under the Internal Revenue Code.

Certain investment companies, including mutual funds, may elect to be taxed as RICs. There are several conditions that must be satisfied to qualify for the election, including (i) 90% of gross income must be derived from dividends, interest, and gains on the sale of stock or securities and (ii) the corporation's investments must be diversified as prescribed by Section 851 of the Internal Revenue Code. A qualified RIC is taxed only on its undistributed income and is treated as a partial conduit for the income it earns. The fundamental premise of conduit treatment is that the RIC's income should be taxed only once, at the shareholder level, rather than to the RIC.

[21] 26 U.S.C. § 243.

Dividends received from RICs are eligible for the federal deduction, subject to additional limitations.[22]

A REIT is a corporation or trust that uses the pooled capital of many investors to purchase and manage real estate. REITs are traded on major exchanges just like stocks and are granted special tax considerations. A REIT pays yields in the form of dividends. It is required to pay out at least 90% of its income to shareholders and deducts the amount paid out, so there is no taxation at the REIT level. The shareholders pay tax on the dividends they receive.

Under prior law, G.S. 105-130.7 provided that a corporation may deduct the proportionate part of dividends received by it from a RIC or a REIT as corresponds to income received by the company or trust that would not be taxed by North Carolina if received directly by the corporation. In other words, dividends received by a corporation from a RIC or REIT were deductible to the extent that income received by that corporation from a RIC or a REIT would not be taxable by North Carolina.

Section 1.1 of the act repeals G.S. 105-130.7.[23] In 2001, the General Assembly piggybacked the federal law with regard to the corporate dividends received deduction, by repealing G.S. 105-130.7(b) and G.S. 105-130.5(a)(7), which had provided corporations with an income tax deduction for dividends received by their subsidiaries. Adopting the federal approach simplified tax administration and compliance because the taxpayer is required to make fewer adjustments to taxable income in order to calculate State net income. The repeal under Section 1.1 of this act is consistent with this philosophy.

Dividends received from a RIC qualify for the federal dividends received deduction. Therefore, despite the repeal of G.S. 105-130.7 by this act, dividends received from RICs will continue to be deductible. The repeal of G.S. 105-130.7 also ensures that dividends received from a RIC are subject to the same rules concerning attribution of expenses as dividends received from other corporations.

Dividends from REITs do not qualify for the federal dividends received deduction. Therefore, under past law, dividends from REITs were taxed more favorably for State tax purposes than under federal law. The repeal of G.S. 105-130.7 ensures that the State treatment of dividends from REITs is the same as under federal law.

Part 2: Avoid Duplicative Reporting Requirements Regarding Sales of Seized Property

If any tax levied by the State and payable to the Department of Revenue has not been paid within 30 days after the taxpayer was given a notice of final assessment of the tax, the Department is authorized to collect the tax through the levy upon and sale of the taxpayer's real or personal property. The Department may direct the sheriff to levy upon and sell property or it may levy upon the property itself through one of its employees.

Most personal property seized by the Department of Revenue is for the payment of unauthorized substance taxes. When the Department employees levy upon the property without the use of the sheriff, the actual sale of the property is conducted by the Department of Administration's State Surplus Property section in accordance with the same notice and bidding procedures that apply to surplus property. The State Surplus Property section posts information

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[22] Capital gain dividends received from a regulated investment company do not qualify for the deduction.

[23] The repeal of G.S. 105-130.5(b)(3) and the changes in Sections 1.2 and 1.3 of the act are conforming changes.

related to bids and sales of seized property both online and in written format, which is available to the public.

The laws in Article 29B of Chapter 1 of the General Statutes, which apply to the sheriff when conducting the levy and sale of property, also apply to the Department of Revenue when it conducts the levy and sale of property. Among those provisions is G.S. 1-339.63, which states that the sheriff must file a report of sale with the clerk of superior court. Because the Department is subject to the same laws governing execution sales, it had construed this provision to mean that the Department must file a report of all sales of seized property with the clerk of superior court.

Because the Department of Administration makes a report of all property sold through the surplus property sales, the Department of Revenue did not see a need to file a report of sale with the clerk of court as well. Therefore, Section 2 of the act amends G.S. 105-242 to provide that the Department of Revenue is not required to file a report of sale of seized property with the clerk of superior court as long as the sale is otherwise publicly reported. This change became effective when the act was signed into law by the Governor on July 27, 2003. In addition to improving efficiency by avoiding duplicative reporting, this change should also reduce costs since several clerks of court have begun charging a fee for filing these reports.

Part 3: Extend Authority to Use Collection Agencies to Collect In-state Tax Debts

Part 3 of this act extends for two years the Department of Revenue's authority to use private collection agencies to collect in-state tax debts. The Department of Revenue has permanent authority to use private collection agencies to collect out-of-state tax debts. The authority to outsource in-state debts was scheduled to expire on October 1, 2003. This act extends it to October 1, 2005. A tax debt is the amount of tax, interest, and penalties due for which a final notice of assessment has been mailed to the taxpayer after the taxpayer no longer has the right to contest the debt.

In 1999, the General Assembly authorized the Department of Revenue to initiate a pilot program whereby the Department would contract for the collection of tax debts owed by nonresidents and foreign entities. In September 2000, the Department, in conjunction with the Office of the State Auditor, began outsourcing some of its out-of-state tax debts. Between September 2000 and May 2001, it collected in excess of $12 million in out-of-state receivables using a combination of outsourcing and in-house collection techniques.

In 2001, the Department of Revenue was authorized to outsource out-of-state tax debts permanently and to outsource in-state tax debts for two years. When outsourcing tax debts, the Department is required to notify the taxpayer prior to submitting the debt to a collection agency. The taxpayer has 30 days after the notice is sent to pay the tax debt. If the debt remains unpaid at the end of the 30 days, then the debt may be outsourced to a collection agency. The collection agencies that contract to collect tax debts are prohibited from revealing confidential tax information. If a contractor reveals tax information, it is subject to a misdemeanor penalty, its contract is terminated, and it is barred from contracting again for five years.

Part 4: Revise Secrecy Provision To Reflect Transfer of DMV Enforcement to the State Highway Patrol

Under the tax secrecy law (G.S. 105-259(b)), an officer, employee, or agent of the State who has access to tax information in the course of service or employment by the State may not disclose the information to any other person except for the purposes expressly authorized by

statute. One of the allowed purposes is to exchange information with the Division of Motor Vehicles of the Department of Transportation when the information is needed to fulfill a duty imposed on the Department of Revenue or the Division of Motor Vehicles.

In 2002, the General Assembly enacted legislation[24] that transferred to the Department of Crime Control and Public Safety the personnel and functions of the Department of Transportation Division of Motor Vehicles Enforcement Section for the regulation and enforcement of commercial motor vehicles, oversize and overweight vehicles, motor carrier safety, and mobile and manufactured housing. The transfer became effective January 1, 2004. In order to preserve the secrecy provision in existing law, Section 4 of the act replaces the phrase "Division of Motor Vehicles of the Department of Transportation" with the phrase "Division of the State Highway Patrol of the Department of Crime Control and Public Safety" because the State Highway Patrol will be performing the functions of the prior DMV Enforcement Section. This change became effective when the act was signed into law by the Governor on July 27, 2003.

Part 5: Base Local Sales Tax Distributions on Taxpayer Data

Pursuant to G.S. 105-472, the Secretary of Revenue makes distributions of local sales and use tax proceeds to cities and counties. In 2001, the General Assembly accelerated these distributions from quarterly to monthly, effective July 1, 2003. This Part provides that each monthly distribution will include tax proceeds for which a return has been filed. Proceeds received the month before the related return is expected to be filed will be held until the month the return is filed. Because the return contains information necessary for determining the distribution formula, distributing some taxes before the related return is filed would result in misallocation of the tax proceeds. This Part became effective July 1, 2003.

As of January 1, 2002, the threshold for taxpayers required to make semimonthly payments of sales and use tax was lowered from $20,000 to $10,000, substantially increasing the total amount of revenues received for processing by the Department on a semimonthly basis. For semimonthly filers, sales and use tax revenues collected between the 1st and 15th of the month must be paid by the 25th of the same month and sales and use tax revenues collected the remainder of the month must be paid by the 10th of the following month. The return for the two semimonthly periods is due 10 days later, on the 20th of the month. Consequently, for revenues received for the first half of each month, the return indicating where the funds should be distributed will not be received until the following month.

Section 5 of the act amends the local government sales and use tax distribution statute by stating that amounts collected by electronic funds transfer payments are included in the distribution for the month in which the return that applies to the payment is due. Semimonthly taxpayers are required to pay by electronic funds transfer. This amendment ensures that the Department of Revenue will distribute local sales and use tax proceeds only after they have the necessary information provided on semimonthly returns.

Part 6: Simplify the Procedure for Hold-Harmless Calculation

In 2001, the General Assembly authorized all counties of the State to levy a third one-half cent sales tax.[25] The same legislation also provided local governments an annual hold-harmless distribution from the State's General Fund to ensure that none of them would lose money when

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[24] S.L. 2002-190, as amended by Section 31.5 of S.L. 2002-159.

[25] Effective July 1, 2004, all 100 counties will have adopted the local option third one-half cent sales tax authorized by Section 34.14 of S.L. 2001-424.

the local government reimbursements are repealed.[26] The hold-harmless distribution provides that if a county or city's estimated proceeds from the third half-cent tax would be less than the amount it would have gotten under the repealed reimbursements, it will receive a payment equal to the difference. If a county or city's estimated gain from the third half-cent tax exceeds its repealed reimbursement amount, it does not receive a hold-harmless payment from the State. The hold-harmless payment would be the same even if a county had not levied the new tax.

Under prior law, G.S. 105-521(b) directed the Office of State Budget and Management (OSBM) and the Fiscal Research Division of the General Assembly to each submit to the Secretary of Revenue and the General Assembly, by May 1 of each year, a projection of the estimated amount that local governments would be expected to receive from the levy of the third one-half cent local sales and use tax during the upcoming fiscal year. Then, by September 15 of each year, the Secretary of Revenue is required to calculate the hold-harmless distribution amounts, if any, based on the projections and to distribute the funds. If the Secretary does not use the lower of the two projections when making the calculation, the Secretary must report the reasons for this decision to the Joint Legislative Commission on Governmental Operations within 60 days after receiving the projections.

Part 6 of the act requires the Department of Revenue, rather than the OSBM, to provide the estimate. From a practical standpoint, the data needed to make the projections are housed within the Department of Revenue. Making this change simplifies the process by eliminating the need for the OSBM to first obtain the data from Revenue and then make the necessary projection. This change became effective when the act was signed into law by the Governor on July 27, 2003.

Part 7: Clarify That the Filing Fee for an Annual Report is Nonrefundable

G.S. 55-1-22 sets out the fees for filing certain documents with the Secretary of State, including documents such as corporations' articles of incorporation, articles of dissolution, designation of a registered agent, etc. Included on the list is a $20.00 fee for filing an annual report. Each corporation authorized to do business in this State is required to file an annual report, which, unlike the other documents in G.S. 55-1-22, must be delivered to the Secretary of Revenue. [27] The annual report contains the name of the corporation, its address, the name and address of its registered agent, the names and addresses of its principal officers, and a brief description of the nature of its business. Annual reports are due by the due date for filing the corporation's income and franchise tax return. As a practical matter, the annual reports are typically attached to the return along with a check for the filing fee.

Part 7 of the act amends G.S. 55-1-22 by adding a new subsection stating that the annual report fee of $20.00 is nonrefundable. This change became effective when the act was signed into law by the Governor on July 27, 2003. The purpose of this change is to codify the Department of Revenue's existing policy that annual report fees are not refundable. G.S. 55-1-22 does not address whether or under what circumstances the filing fees are refundable. However, it is the policy and practice of the Secretary of State to issue refunds for those fees, if requested and depending on the circumstances. Specifically, if the Secretary of State's office has not begun to process or review the document for which the refund is requested, then it will usually refund the filing fee at the filer's request, regardless of whether the fee has been

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[26] The 2003 General Assembly limited this distribution to two years, 2003 and 2004, but stated the intent that it would continue through 2012. *Part 37 of S.L. 2003-284.*

[27] Nonprofit corporations are exempt from this requirement and insurance companies are required to deliver their annual reports to the Secretary of State.

deposited. The Department of Revenue's policy with regard to the annual report is that the fee is nonrefundable.

Part 8: Clarify Eligibility for R&D Credit

The William S. Lee Quality Jobs and Business Expansion Tax Credits, in Article 3A of Chapter 105 of the General Statutes, are allowed only to certain types of businesses.[28] For most of the eligible business types, the law specifies that the taxpayer's primary business must be the designated business. For a few of the business types, including computer services, the law requires only that the taxpayer's primary activity at an establishment be the designated business. In addition, to qualify for the credits, the jobs, investment, or activity must be used in the designated business or activity.

One of the credits under the Bill Lee Act is for research and development. Generally, a taxpayer that claims a federal income tax credit for increasing research activities under section 41 of the Internal Revenue Code is allowed a State credit as well for the eligible research activities conducted in North Carolina. The amount of the credit varies, depending upon which type of federal credit is claimed.[29] Under the Department of Revenue's interpretation of the Bill Lee Act, to satisfy the eligible business requirements, the jobs, investment, and activity must be located at an establishment where the primary activity is an eligible business or eligible activity.

The question arose whether a taxpayer's qualified research expenditures must have occurred on the premises of an establishment that performed an eligible industry activity. Under the Department's past interpretation of the law, the answer was yes. Part 8 of the act purports to clarify the original intent of the General Assembly that research and development activities need not be on the same premises as an eligible activity. It extends this clarification to the legislature's recent relaxation of the eligible business requirements surrounding computer services. The act provides that if the primary activity of an establishment of the taxpayer in this State is computer services, then the taxpayer's qualified research expenditures in this State are considered to be used in computer services. For all other taxpayers, the expenditures are considered to be used in the primary business of the taxpayer. The changes are retroactive to the years the related provisions were effective, 2001 and 1996, respectively.

Part 9: Revenue Laws to Study Data Needed to Estimate Impact of Consolidated Returns

Whenever study committees discuss tax modernization, one of the issues that arises is the State's corporate income tax structure. The corporate tax structure has remained substantially unchanged for years. In the course of these discussions, the Fiscal Research Division and the Tax Research Division of the Department of Revenue have been asked what the fiscal consequences would be if the State allowed consolidated corporate income tax returns. Currently, neither has enough information to form a credible estimate.

Part 9 of the act directs the Revenue Laws Study Committee to establish a study group composed of tax professionals and representatives of the Department of Revenue to gather appropriate data that will allow the Department to estimate the fiscal impact of consolidated returns. Part 9 becomes effective with the 2003 tax year and expires in two years.

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[28] Central office or aircraft facility; air courier services or data processing; manufacturing, warehousing, or wholesale trade; computer services or electronic mail order house; customer service center; or warehousing at an establishment.

[29] The credit amount is 5% of the State's apportioned share if the taxpayer claims the credit under section 41(a) of the Code or 25% if the taxpayer claims the alternative incremental credit under section 41(c)(4) of the Code.

Part 10: Motor Fuel Tax Changes

This Part makes several changes to the motor fuel tax laws, effective January 1, 2004. It provides the Department of Revenue with greater enforcement capabilities, it protects the State's interest with a shorter temporary permit for motor carriers and a higher bond requirement for distributors, and it makes the motor fuel statutes more equitable by extending the inspection tax to dyed diesel fuel. It also makes several technical and administrative changes.

This Part strengthens the Division of Motor Fuel's enforcement capabilities in the following ways:

- Sections 10.3 and 10.4 require a taxpayer that imports motor fuel from an out-of-state terminal into North Carolina to be licensed as a distributor. Past statutes made the distributor's license optional. If the product was being imported, the taxpayer was required to register as a licensed importer but none of the importer categories fit a taxpayer obtaining tax-paid fuel from an out-of-state terminal. For example, the taxpayer would not owe tax directly to the Department, but an importer's license requires the taxpayer to file a return on a monthly basis. The Department of Revenue had determined that a distributor's license, which allows the taxpayer to import and export the product but does not require periodic returns, was more appropriate. The Department had implemented this change administratively; Sections 10.3 and 10.4 change the statutes accordingly. Section 10.5 removes the requirement that an applicant for licensure as a distributor or an importer notify the Department of any states to which it plans to export or from which it plans to import motor fuel, because there is no means for tracking this information.

- Section 10.7 enables the Department to deny a motor fuel license to a taxpayer that fails to file a return or pay any tax debt due under Chapter 105 or 119 of the General Statutes.

- Section 10.10 clarifies the Department's authority to investigate illegal use of non-tax-paid fuel for highway use. One way the Department investigates alleged violations is through undercover operations. Investigators will film an operation in which an agent will drive a State truck to a retailer and ask to fill it with dyed (non-tax-paid) fuel. It would be a violation for the retailer to permit the purchase of non-tax-paid fuel for highway use. Technically, however, the fuel in this situation is not taxable because G.S. 105-449.88 exempts motor fuel sold to the State for its use. This section specifies that it is not a valid defense to a violation of the motor fuel tax statutes that the State is exempt from motor fuel tax.

- Sections 10.12 through 10.14 require kerosene terminal operators to be licensed and to file reports. Currently, jet fuel and kerosene are being delivered from the pipeline directly to airports. This method of delivery bypasses the motor fuels terminals and thereby bypasses the record-keeping requirements that help ensure that the Department can uniformly enforce the tax statutes. Kerosene terminal operators are currently subject to tax. The Internal Revenue Service licenses these terminals and the terminal operators must report deliveries to the airports. These sections do not subject the airports to greater tax liability, but require them to be licensed and to file reports so the Department can identify the taxpayers and ensure that they are paying the requisite amount of tax. As a result, the State should begin collecting an unknown amount of inspection tax revenue that was otherwise falling through the cracks. Section 10.16 provides a licensed kerosene distributor the same benefits of deferred payments and discounts that a

licensed motor fuel distributor receives. Finally, these sections reorganize and modernizes the language of the kerosene licensing statutes.

Section 10.1 reduces from 20 days to 3 days the maximum time a motor carrier can operate in the State using a temporary permit, rather than obtaining a license. A licensed motor carrier pays tax based on the number of miles driven in the State. The cost of a temporary permit is $50. It would take approximately 1,000 miles to exceed the $50 temporary permit fee in taxes. A motor carrier can drive far more than 1,000 miles in 20 days and thus could get many "free" miles by obtaining a temporary permit. Three days is a better approximation of the time in which a motor carrier would use $50 worth of miles. The Department surveyed numerous states and determined that, of the 26 states where permit information was available, 7 states issued 3-day permits, 5 states issued permits for between 4 and 7 days, 5 states issued 10-day permits, 1 state issued a 13-day permit, and 1 state issued a 20-day permit. Seven states did not issue temporary permits. Section 10.1 could increase Highway Fund revenues by increasing the number of permits issued or the number of permanent licenses issued. No estimate is available for the permit volume.

Section 10.6 increases the cap on the bond amount of motor fuel licensees to $500,000. The most recent bond cap amount of $250,000 was last adjusted in January 1991. The Department believes the maximum bond amount should be increased to $1 million. Since 1991, licensees' tax liabilities have increased to a point that 28% of the current licensees have a monthly tax liability of over $250,000, 18.3% over $500,000, 13.17% over $750,000, and 8.48% over $1 million. In the last six months there have been four bankruptcy cases, two of which exceeded the taxpayer's bond amount. In one of these cases, the potential loss to the State is in excess of $1 million after payment from the surety company. A survey of the surrounding states shows that South Carolina, West Virginia, Kentucky, and Louisiana do not have a cap; Florida has a $100,000 cap; Virginia has a $300,000 cap; Georgia has a $150,000 cap; and Maryland has a $500,000 cap.

Section 10.15 imposes the inspection tax on dyed diesel. The Department of Revenue estimates that this change will yield an additional $1.2 million of inspection tax a year. The inspection tax is currently imposed on all other fuel types at the rate of one-fourth of one cent per gallon[30] including dyed kerosene, which, like dyed diesel, is used for heating and other non-highway purposes. The Department conducts monthly on-road investigations for the misuse of dyed fuels, including dyed diesel. Each sample of fuel withdrawn must be tested by the Department of Agriculture for evidence of dye in the fuel.

Lastly, Part 10 makes the following technical and administrative changes:

- Section 10.2 clarifies that the definition of a tank wagon includes vehicles designed to carry at least 1,000 gallons of motor fuel. The past definition appeared to exclude those vehicles that can carry a total of more than 1,000 gallons but have individual tanks that are less than 1,000 gallons each.
- Section 10.8 conforms the statutes with the legislative change made last session to exempt local governments from the motor fuel tax.

[30] The inspection tax is imposed regardless of whether the fuel is exempt from the per-gallon excise tax. The proceeds of the tax are applied first to the cost of administering the Motor Fuels Tax Division. The remainder is credited to the Commercial Leaking Petroleum Underground Storage Tank Cleanup Fund and the Noncommercial Leaking Petroleum Underground Storage Tank Cleanup Fund.

- Section 10.9 removes the requirement that shipping documents must be machine-printed by the operator of a bulk plant. This requirement was imposed inadvertently when the statutes were reorganized. Bulk plant operators do not have the necessary equipment and the Department does not need them to provide machine-printed documents. The act does not change the requirement that terminal operators must machine-print shipping documents.
- Section 10.11 clarifies that storage facilities for dyed kerosene must be clearly marked for non-tax use only, just like the storage facilities for dyed diesel fuel. It also provides that the dispensing device for dyed fuel must be clearly marked as non-tax use only.

Part 11: Charge-off of Bad Debts

Retailers pay sales tax on their gross sales. If accounts of purchasers are found to be worthless and are charged off for income tax purposes, then the retailer may deduct those sales from its gross sales. Municipalities that sell electricity are considered to be retailers and pay State sales tax on their gross sales of electricity. The practice of the Department of Revenue was to allow the municipalities to charge-off their bad debts as other retailers are allowed to do. However, municipalities could not technically meet the conditions of the statute because they do not pay federal income tax. This Part conforms the statute to the Department's practice by clarifying that municipalities that sell electricity may deduct worthless accounts from their gross sales for sales tax purposes. Worthless accounts are determined in the same way as they would be determined under the Internal Revenue Code if municipalities were taxed. As under current law, the accounts that are collected afterwards must be added back to gross sales. Part 11 became effective when the act was signed into law by the Governor on July 27, 2003.

MODIFY UNC BOND LAW.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-357	**SB 633**	**Senator Clodfelter**

AN ACT TO REVISE THE UNIVERSITY OF NORTH CAROLINA SPECIAL OBLIGATION BOND LAW.

OVERVIEW: This act modifies the special obligation bond law that applies to The University of North Carolina system (UNC). It makes the maximum maturity for special obligation bonds more consistent with other University debt obligations by increasing the maximum maturity of special obligation bonds from 25 years to 30 years. It also increases the maximum maturity for special obligation bond notes from 2 years to 30 years, which provides UNC with greater flexibility to provide interim financing at lower costs.

FISCAL IMPACT: This act does not have an impact on the General Fund.

EFFECTIVE DATE: This act became effective when signed into law by the Governor on August 1, 2003.

ANALYSIS: In 2000, the General Assembly authorized the UNC Board of Governors to issue special obligation bonds payable from any sources of income or receipts of the Board of Governors or a constituent or affiliated institution, but not including tuition payments or appropriations from the General Fund from State revenues. The bond proceeds can be used for construction, improvement, and acquisition of capital facilities located at UNC constituent

and affiliated institutions. The maximum maturity on the bonds was set at 25 years. Special obligation bonds are not general obligation bonds and thus are not required to be approved by the voters. They are not secured by the full faith and credit or the taxing power of the State; a statement to this effect appears on the face of the bonds. Property cannot be pledged to secure the bonds.

The UNC special obligation bonds can be issued only for projects specifically authorized by the General Assembly. In submitting proposed special obligation bond projects to the General Assembly for approval, the Board of Governors is required to justify the need for each project and to itemize the cost of the project, the estimated operating costs upon completion, and the sources and amounts of resources to be pledged for repayment of the bonds. The Board of Governors can issue special obligation bonds for a project only if the board of trustees of the institution at which the project will be located has approved the project.

This act provides UNC with greater flexibility in amortizing its debt obligations and in structuring interim financing debt obligations. The act does not authorize the University to issue additional debt beyond currently authorized levels and it maintains the requirement that the University obtain explicit approval from the General Assembly to issue debt.

The act changes the maximum maturity on special obligation bonds from 25 years to 30 years. This change makes the maximum maturity of special obligation bonds more consistent with other University debt obligations. The maximum maturity for University revenue bond debt issued for student housing and activities, physical education, and recreation[31] is 50 years. The maximum maturity for University revenue bond debt issued for the Centennial Campus, the Horace Williams Campus, and Millennial Campuses[32] is 40 years.

The act also makes it easier and less costly to provide short-term, interim financing for bond projects authorized by the General Assembly. Under prior law, interim financing was provided through a bond anticipation note that would be issued for each individual project. A bond anticipation note could not exceed two years. The University proposed a less costly method of interim financing under which there would be a one-time issuance of notes. Under the program, interim financing for projects would be drawn down from a line of credit as needed and repaid by draws from the permanent, long-term bond proceeds. This approach creates a pool of resources to provide interim financing that can be used multiple times for many projects. To accomplish this method of pooled financing, the act extends the maximum maturity of bond anticipation notes from 2 to 30 years. Longer-term bond anticipation notes reduce the issuance costs associated with notes that must be reauthorized every two years and allow for better interest rates to be obtained through the long-term market. To ensure that the bond anticipation note proceeds are used for short-term, interim financing needs only, the act provides that if the Board of Governors issues a bond anticipation note for a term in excess of three years, no individual project may be funded from the proceeds of the note for longer than three years.

UNC - NONAPPROPRIATED CAPITAL PROJECTS.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-360	**SB 705**	**Senator Kerr**

[31] Article 21 of Chapter 116 of the General Statutes.
[32] Article 21B of Chapter 116 of the General Statutes.

AN ACT TO AUTHORIZE THE CONSTRUCTION AND THE FINANCING, WITHOUT APPROPRIATIONS FROM THE GENERAL FUND, OF CERTAIN CAPITAL IMPROVEMENTS PROJECTS OF THE CONSTITUENT INSTITUTIONS OF THE UNIVERSITY OF NORTH CAROLINA.

OVERVIEW: This act authorizes the construction of numerous projects by The University of North Carolina. The projects will be financed through revenue bonds and special obligation bonds. No funds from the General Fund will be appropriated to finance the projects. In addition to bond-financing, the act authorizes the construction and financing of three capital projects at UNC-Chapel Hill through lease arrangements with nonprofit corporations.

FISCAL IMPACT: This act will require 12 new positions at a cost to the General Fund of roughly $500,000 a year beginning January 1, 2005. These positions are required for increased operating costs resulting from The Rizzo Center Expansion and the McColl Building Addition at UNC-Chapel Hill.

EFFECTIVE DATE: This act became effective when signed into law by the Governor on August 1, 2003.

ANALYSIS: The Board of Governors of The University of North Carolina can issue two types of self-liquidating bonds, revenue bonds and special obligation bonds. Tax revenues may not be used to pay back either type of bond. Article 21 of Chapter 116 of the General Statutes authorizes the Board of Governors to issue revenue bonds for the types of projects enumerated in the Article. The types of projects for which revenue bonds may be issued include educational buildings, dormitories, recreational facilities, dining facilities, student centers, health care buildings, parking decks, etc. The revenue bonds are payable from rentals, charges, fees, and other revenues generated by the facility. Article 21B of Chapter 116 of the General Statutes authorizes the Board of Governors to issue revenue bonds for projects at the Centennial Campus, the Horace Williams Campus, and Millennial Campuses. The revenue bonds are payable from rentals, charges, fees, and other income generated by the facility. Article 3 of Chapter 116D of the General Statutes authorizes the Board of Governors to issue special obligation bonds payable with any sources of income or receipts of the Board of Governors or a constituent or affiliated institution, but not including tuition payments or appropriations from the General Fund from State revenues. In this instance, the bond proceeds could be used for construction, improvement, and acquisition of any capital facilities located at UNC constituent and affiliated institutions.

The purpose of this act is to authorize the construction and financing of the capital improvements projects at various constituent institutions of The University of North Carolina. The projects authorized in the act may not be financed with funds appropriated from the State's General Fund, but may be financed with gifts, grants, receipts, self-liquidating indebtedness, other funds available to the constituent institutions, or a combination of any of those financing methods. The new self-liquidating projects that the Board of Governors may finance with revenue bonds, special obligation bonds, or both are listed in Section 2 of the act. Section 3 authorizes revenue bonds and special obligation bonds to be used for eight capital improvements projects for which general obligation bond financing was previously authorized in S.L. 2000-3. This act provides additional options for financing the projects.

Section 4 authorizes the Director of the Budget, at the request of the Board of Governors, to authorize cost increases or decreases, or changes in the method of financing for the projects authorized by the act. The Director of the Budget may consult with the Joint Legislative Commission on Governmental Operations, but consultation is not required.

The current law governing UNC special obligation bonds requires that the specific projects and their costs be set forth in legislation approved by the General Assembly and that the maximum amount of special obligation bonds to be issued to finance the specific projects listed be stated. Sections 2 and 3 set forth the specific projects and their costs. Section 5 expressly states that the maximum principal amount of special obligation bonds to be issued shall not exceed the amounts listed in Sections 2 and 3 plus $15 million for related additional costs for which bond proceeds are routinely used, such as issuance expenses, funding of reserve funds, and capitalized interest.

Section 6 authorizes the financing of three projects at UNC-Chapel Hill through lease arrangements with nonprofit corporations. Over the years, the University system has used lease arrangements with nonprofit corporations to construct facilities necessary to academic life, student support services, physical education and recreation, athletics, and other programs when the facilities are financed by major gifts. The process followed by the State is as follows:

- The State, following guidelines established by the Department of Administration and with Council of State approval, leases land to the nonprofit corporation for the period of time required for the construction of the facility.
- The nonprofit corporation, after review and approval of construction plans by the State Construction Office, builds the facility. Each project is subject to review by the Department of Insurance to ensure that it meets State Building Code requirements.
- When construction is completed and the facility has been deemed acceptable to the State, the lease expires and the land returns to the State's control, along with the newly constructed facility.

The difference between the three projects named in Section 6 of the act and other projects constructed in this manner is that the act authorizes the University to issue long-term debt as a means of financing the indebtedness.

MODIFY STATE FINANCING LAWS.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-388	**SB 679**	**Senator Hoyle**

AN ACT TO MODIFY THE PUBLIC FINANCING LAWS OF THE STATE.

OVERVIEW: This act makes the following changes to the State public financing laws, as requested by the State Treasurer's Office:

- Authorizes the use of out-of-state banks as well as in-state banks as trustee under a revenue bond order or a trust agreement securing revenue bonds
- Allows term bonds with sinking fund redemptions to satisfy the statutory requirements for maturities
- Exempts refunding bonds from the "four times" rule
- Allows local governments to use installment purchase debt to refinance debt for purposes for which installment debt is currently authorized

- Clarifies and regulates the authority of a local government to enter into an interest rate swap agreement in connection with bond issuance

FISCAL IMPACT: No impact.

EFFECTIVE DATE: This act became effective when signed into law by the Governor on August 7, 2003.

ANALYSIS: Section 1 of the act is in response to the recent decline in the number of North Carolina financial institutions offering trustee services as a result of mergers and financial institutions selling their trust businesses. Allowing financial institutions outside of North Carolina to serve as trustee under a revenue bond order or a trust agreement securing revenue bonds gives issuers more choices and also would allow issuers to continue doing business with the same trustee staff person who becomes employed by an out-of-state trustee as a result of a merger or sale of a North Carolina financial institution's trust business. Revenue bonds are bonds that are secured by and repaid from revenues generated by the facility being financed. For example, parking lots generate parking fees, dorms generate dorm fees, and water and sewer infrastructure generate water and sewer fees.

Under current law, the Local Government Bond Act requires each issue of bonds to mature in annual installments with the first installment being paid no more than three years after the date of the bonds. This means that the only type of bonds that can be issued is serial bonds, in which some mature each year. Section 2 of the act would change the requirement so that the bonds themselves do not have to mature in annual installments as long as the principal is paid in annual installments beginning within three years after the date of the bonds. Thus, the purpose of the requirement, to provide for regular payments on the debt, is still met. This will allow a choice between serial bonds as under current law and term bonds with "sinking fund" redemptions. Underwriters have indicated that allowing term bonds in addition to serials would expand the investor base by attracting more institutional investors, thereby possibly resulting in lower rates to the issuer.

Section 2 also exempts refunding bonds from the four-times rule and makes clarifying changes to the statute. The four-times rule provides that no principal installment may be more than four times as great as the smallest prior principal installment. The application of this rule to advance refundings where the refunded bonds are scheduled to mature several years from the issue date means that issuers are often forced to start the maturity of the refunding bonds sooner than would otherwise be required and also may be required to refund some non-callable bonds. This results in increased and unnecessary costs to issuers.

Section 3 of the act amends the language of the local government installment purchase statute to clarify that local governments may use installment contracts to refinance debt originally incurred for purposes for which installment contracts are currently authorized. Installment purchase financing is a type of debt in which a government enters into an installment contract secured by a security interest in the building constructed or renovated. Unlike the issuance of general obligation bonds, installment purchase financing is not subject to a vote of the people. Certificates of participation may be issued as part of the installment purchase financing. A certificate of participation is a document setting out the share of the government's debt that is owed to the holder of the certificate. In practice, the holder receives interest and principal payments in a manner similar to interest and principal payments on a bond issued by the borrowing unit.

According to the State Treasurer's Office, some North Carolina local governmental units have entered into interest rate swap agreements in connection with the issuance of bonds. While there

is no express statutory authority, most, if not all, law firms with a North Carolina bond counsel practice have concluded that local governmental units are authorized to enter into these agreements based on their general power to contract. Several questions have remained, however, with respect to certain terms of the swap documentation required by financial institutions. Section 4 of the act makes the following changes:

- Specifically authorizes governmental units to enter into swap agreements in connection with the issuance of obligations, including the details of the terms and conditions.
- Authorizes local governmental units to pledge collateral (concurrently with the entry into the swap transaction or in the future) to secure the local governmental unit's obligations under the swap agreement.

The act provides that a swap agreement is subject to Local Government Commission approval if a local government or other entity that is under the supervision of the Commission enters into it, or if the underlying debt to which it relates is subject to approval by the Commission. Approval is not required for swap agreements relating to conduit financing, where a government incurs debt on behalf of a private entity.

PROPERTY TAX CERTIFICATION PROCEDURE.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-399	**HB 972**	**Representative Culpepper**

AN ACT TO ALLOW AN INTERNET-BASED ALTERNATIVE TO PROPERTY TAX CERTIFICATION PROCEDURES.

OVERVIEW: This act authorizes the governing body of a county or municipality to adopt an ordinance allowing a person to rely on information as to the amount of taxes due on real property obtained from the taxing unit's Internet website to the same extent as a written certification issued by the tax collector.

FISCAL IMPACT: This act has no fiscal impact.

EFFECTIVE DATE: The act became effective when signed into law by the Governor on August 7, 2003.

ANALYSIS: G.S. 105-361 provides that upon request of specified persons - including an owner or occupant of real property, a person holding a lien or legal interest in the property, a person with a contract to purchase or lease the property, or a person or firm that has contracted to make a loan secured by the property – the tax collector must furnish a written certificate stating the amount of any taxes and special assessments for the current year and any amounts still pending collection from prior years. When the certificate is issued, all taxes and special assessments that have accrued against the property for the period covered by the certificate cease to be a lien against the property, except to the extent of taxes and special assessments stated to be due in the certificate. This is applicable to all persons and entities who obtain the certificate and who rely on the certificate by either paying the amount of taxes and assessments stated in the certificate to be a lien on the real property, purchasing or leasing the real property, or lending money secured by the real property. The tax collector is liable on the collector's bond for any loss to the taxing unit arising from an understatement of the tax and special assessment obligations in the preparation of a certificate.

This act amends the existing statute concerning the tax collector's statement of the amount of taxes due on real property by adding a provision that allows a person to rely on information obtained from an Internet website maintained by the taxing unit if the governing body adopts an ordinance allowing it. If an ordinance is adopted, then a person may rely on information obtained from the website as if it were a traditional certificate. The ordinance may provide for procedural provisions by which the tax collector may ensure full and accurate payment of all taxes, assessments, and obligations certified via the Internet website. The ordinance may also include disclaimers and the person may only rely on the information obtained from the website to the extent allowed by the disclaimers. The disclaimers must be posted on the website and could include such matters as the date on which the information was posted, the date as of which the information is current, and any special instructions and procedures for accessing complete and accurate information. If the ordinance adopted provides for disclaimers, then the tax collector would not be liable for any loss to the taxing unit arising from an understatement of the tax or special assessment obligations contained in the information available on the website. A person who relies on the website information must keep and present a copy of the information as if the copy were a traditional written certificate issued by the tax collector.

MANUFACTURED HOUSING.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-400	**HB 1006**	**Rep. Hunter, Barnhart, (Primary Sponsors)**

AN ACT TO GRANT GREATER CONSUMER PROTECTION TO RESIDENTS OF MANUFACTURED HOUSING IN NORTH CAROLINA, TO CLARIFY THE SALES TAX ON MODULAR HOMES, AND TO ESTABLISH MINIMUM CONSTRUCTION AND DESIGN STANDARDS FOR SINGLE-FAMILY MODULAR HOMES.

OVERVIEW: This act makes the following changes to laws affecting manufactured homes and modular homes:

- Expands the definition of manufactured homes that qualify as real property under the property tax laws to include manufactured homes on land leased by the manufactured homeowner for a term of at least 20 years and where the lease expressly provides for disposition of the manufactured home upon termination of the lease. This change makes it easier for the owners of manufactured homes placed on the leased land to qualify for Freddie Mac mortgages.
- Authorizes the Division of Motor Vehicles to charge a $5.00 fee for the cancellation of a certificate of title to a manufactured home that qualifies as real property.
- Requires the owner of a manufactured housing community to give prior notice to each owner of a manufactured home in the community if the community owner intends to convert the community to another use that would require movement of the homes.
- Expands consumer protections for purchasers of manufactured homes.
- Requires a criminal history check on an applicant for licensure as a manufactured home manufacturer, dealer, salesperson, or set-up contractor.

- Imposes a 2.5% sales and use tax rate on the sales price of each modular home. This replaces the current practice of applying two different sales tax rates based on whether the modular home is built on a steel frame or a wood frame. This change in sales and use tax treatment of modular homes was proposed by the North Carolina Manufactured Housing Institute (NCMHI) and approved by the Department of Revenue. Both the NCMHI and the Department agreed that the change would simplify the administration of sales and use tax on modular home transactions. The act does not amend the sales and use tax treatment of manufactured homes.
- Amends the definitions of manufactured home and modular home. A manufactured home is a dwelling manufactured to meet or exceed the specifications contained in the Federal Manufactured Housing Code issued by the United States Department of Housing and Urban Development. A modular home is a factory-built dwelling that must (1) be manufactured to meet or exceed the specifications contained in the North Carolina Residential Building Code, and (2) bear a seal or label issued by the Department of Insurance that the modular home meets or exceeds statutory minimum standards for modular homes as enacted in the act.
- Imposes minimum standards for modular homes.

FISCAL IMPACT: The change in the sales tax treatment of modular homes and the $5.00 fee imposed by the North Carolina Division of Motor Vehicles (DMV) are expected to increase revenues to the General Fund and the DMV as follows:

	FY 2003-04	FY 2004-05	FY2005-06	FY 2006-07	FY 2007-08
REVENUES					
General Fund	$579,425	$1,279,488	$1,279,488	$1,279,488	$1,279,488
DMV	17,075	17,075	17,075	17,075	17,075

The change in the sales tax treatment of modular homes is expected to increase sales tax revenues to local governments over the same period as follows:

	FY 2003-04	FY 2004-05	FY 2005-06	FY 2006-07	FY 2007-08
REVENUES					
Local Gov.	$59,125	$119,712	$119,712	$119,712	$119,712

These numbers assume that 70% of current modular homes are sold "on-frame."[33] If the actual "on-frame" percentage is below approximately 50%, the State and local governments will see a net loss. In addition, if growth in the "on-frame" home market occurs at a faster rate than the "off-frame" market, the State will also see a revenue loss. *(For a more complete fiscal analysis, see the Overview: Fiscal and Budgetary Actions, 2003 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: See Analysis.

ANALYSIS:

Expansion of Definition of Manufactured Homes that Qualify as "Real Property"

[33] An explanation of "on-frame" modular homes is under the subheading, *Sales and Use Tax Treatment of Modular Homes*, found in the analysis of the act.

Under prior law, a manufactured home was considered real property for property tax purposes only if it was a residential structure; had the moving hitch, wheels, and axles removed; and was placed upon land owned by the owner of the manufactured home. The owner of a manufactured home that had been placed on property owned by that owner could convey or encumber the property and manufactured home by a mortgage. If the manufactured home had not yet been placed upon the property and the owner desired to convey or encumber the property with a mortgage, the owner could record in the county register of deeds office a declaration of intent to affix the manufactured home to the real property. If the owner of a manufactured home did not own the land on which the home was located, then the manufactured home was considered tangible personal property for property tax purposes.

If a manufactured home qualifies as tangible personal property, then it is subject to the same registration and certificate of title requirements that apply to motor vehicles. If a certificate of title has been issued for a manufactured home and the home subsequently qualifies as real property, the owner must surrender the certificate of title and file an affidavit with the Division of Motor Vehicles (DMV) indicating that the home meets the statutory definition of real property. The DMV must cancel the title to the manufactured home once the affidavit is filed. The owner of the manufactured home must also file a copy of the affidavit with the register of deeds in the county where the real property and affixed manufactured home are located.[34]

Section 4 of the act expanded the definition of a manufactured home that qualifies as real property to include a manufactured home on land leased by the manufactured homeowner for a term of at least 20 years if the lease expressly provides for disposition of the manufactured home upon termination of the lease. Sections 1, 2, and 3 of the act made conforming changes to the motor vehicle laws and the register of deed laws that require the manufactured homeowner to file an affidavit with the DMV and register of deeds when the manufactured home meets this expanded definition. Section 1 of the act authorizes the DMV to charge a $5.00 fee for the cancellation of a certificate of title to a manufactured home.

Sections 1 through 4 of the act became effective when signed into law by the Governor on August 7, 2003.

Notice of Conversion of Manufactured Home Communities

Section 5 of the act adds a new section to the laws governing landlords and tenants in Chapter 42 of the General Statutes. This new section requires the owner of a manufactured housing community to give 180 days prior notice to each owner of a manufactured home in the community if the community owner intends to convert the community to another use that would require removal of the homes. If the closure is due to a valid order of the State or a local government, then notice of the closure must be given within three days after the date of the order. A manufactured home community is defined as a parcel of land designed to accommodate at least five manufactured homes.

Section 5 of the act is effective October 1, 2003.

Consumer Protections for Purchasers of Manufactured Homes

Section 7 of the act expands the protections afforded purchasers of manufactured homes as set out in Article 9A of Chapter 143 of the General Statutes. These new protections are:

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[34] S.L. 2001-506 codified the policy of the DMV requiring a manufactured homeowner to submit an affidavit and surrender the certificate of title to the DMV when the manufactured home becomes real property. That legislation also required the owner to file the affidavit with the county register of deeds.

- If the manufacturer of a manufactured home publishes the suggested retail price, then that price must also be displayed near the front entrance of the manufactured home.
- A manufactured home dealer must display a sign and provide each buyer with information about the North Carolina Manufactured Housing Board, the procedure for filing a consumer complaint with the Board, and the warranties and protections provided for each new manufactured home under federal and State law.
- A purchase agreement must contain a statement that the purchaser has the right to cancel the purchase within three days after the purchaser has signed the agreement, and that the agreement is canceled if the dealer changes any of the material terms of the agreement. The return of any deposit must be made if either of these actions occurs. Each time the dealer gives the purchaser a new set of financing terms that are less favorable to the purchaser, the purchaser is given another three-day cancellation period.
- The Board must adopt rules concerning deposits, including rules protecting the deposits from the claims of a dealer's creditors in bankruptcy and rules providing for the prompt return of deposits if the purchasers are entitled to their return. These rules may exempt deposits of less than $2,000.

Section 7 of the act became effective October 1, 2003.

Criminal Record Checks

Sections 8 through 11 of the act require applicants for licensure from the North Carolina Manufactured Housing Board to consent to a criminal record check. This requirement applies to a manufactured home manufacturer, dealer, salesperson, or set-up contractor. Refusal of the applicant to consent to a criminal history record check may constitute grounds for the Board to deny licensure. Conviction of a crime specified in the act does not automatically bar licensure, but it is one of the factors the Board must consider when determining whether to grant or deny licensure. The Board may require that the applicant pay a fee to cover the cost of the criminal history record check. Section 12 of the act requires the Board to provide to the Department of Justice the fingerprints of the applicant and a form signed by the applicant consenting to the record check. The State Bureau of Investigation, located within the Department of Justice, will conduct the record check.

Sections 8 through 12 of the act are effective January 1, 2004.

Sales and Use Tax Treatment of Modular Homes

Under the law before January 1, 2004, the sales and use tax treatment of modular homes depended upon the type of frame of the modular home. According to industry representatives, there are two types of modular homes. "On-frame" modular homes are built on a steel chassis and are typically delivered to the home site by means of wheels and axles attached to the steel frames. On-frame modular homes, which are generally sold pursuant to sales contracts, were taxed at the same sales and use tax rate as manufactured homes: 2%, with a maximum tax of $300 per section. The tax derived from these sales goes to the General Fund. "Off-frame" modular homes are typically delivered to the site on a flatbed truck or other carrier and are generally sold pursuant to "performance contracts" in which the seller constructs the home for the buyer. Off-frame modular homes were not taxed to the ultimate consumer, but instead the general sales tax rate of 7% (4 ½% State and 2 ½% local) applied to the cost of the materials used by the seller to create the home.

Section 15 of the act removes this tax distinction and taxes the sales price of both types of modular homes at a rate of 2.5% with no cap.[35] To offset the loss of local sales tax revenue, Section 16 of the act requires that 20% of the taxes collected on modular homes must go to counties and be distributed with local sales tax revenue that is not attributable to a particular county. Section 14 of the act defines a modular home, for sales and use tax purposes, as a factory-built structure that is designed to be used as a dwelling, is manufactured in accordance with the specifications for modular homes under the North Carolina State Residential Building Code, and bears a seal or label issued by the Department of Insurance. The act defines a modular homebuilder as a person who furnishes for consideration a modular home to a purchaser that will occupy the modular home. The purchaser can be a person that will lease or rent the unit as real property. Section 13 of the act amends the definition of "manufactured home" by deleting the reference to modular homes.

Sections 13 through 16 of the act are effective January 1, 2004, and apply to sales of modular homes on and after that date.

Minimum Construction Standards for Modular Homes

Manufactured buildings bearing a label or seal acceptable to the Building Code Council are deemed to meet the requirements of the State Building Code and Article 9 of Chapter 143 of the General Statutes.[36] Section 17 of the act adds new language to Article 9 providing that a single-family modular home will qualify for the label or seal if it meets the following construction and design standards:

- A roof pitch of at least five feet rise for every 12 feet of run.
- Eave projections of at least 10 inches.
- Exterior wall height of at least seven feet six inches for the first story.
- Siding and roofing material commonly used in standard residential construction.
- Foundation supports around the perimeter of the home.

Section 17 of the act is effective January 1, 2004.

WINE SHIPPERS PERMITS.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-402	**SB 668**	**Senator Metcalf**

AN ACT TO AUTHORIZE THE ALCOHOLIC BEVERAGE CONTROL COMMISSION TO ISSUE WINE SHIPPERS PERMITS TO ALLOW THE DIRECT SHIPMENT OF WINES TO RESIDENTS OF NORTH CAROLINA AND TO ESTABLISH A MECHANISM FOR COLLECTING THE TAXES DUE ON WINE SHIPPED TO NORTH CAROLINA.

OVERVIEW: This act remedies an unconstitutional exception in the State's ABC laws that allowed only in-state wineries to ship wine to North Carolina residents. The United States Court of Appeals for the Fourth Circuit recently held that the exception violated the Commerce Clause

[35] Manufactured homes will continue to be taxed at 2% with a $300 cap.

[36] Article 9, *Building Code Council and Building Code*, describes the organization and duties of the Council and the requirements of the Code. The Council's main duty is to prepare and adopt the Code.

of the United States Constitution; the court left the task of fashioning the appropriate remedy to the General Assembly. This act creates a new permit under the ABC laws that would allow any winery to ship wine directly to individuals in North Carolina and it provides a mechanism for the collection of excise and sales and use taxes on direct shipments of wine.

FISCAL IMPACT: There will be some General Fund revenue gain from the imposition of the wine shipper permit and from the collection of additional excise and use taxes. However, the amount is undeterminable. Although the potential applicant pool for a wine shipper permit is large (between 1,500 and 3,000 wineries), the actual number that will seek a permit is expected to be small.[37] *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2003 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The act becomes effective October 1, 2003.

ANALYSIS: After the end of Prohibition in the 1930s, North Carolina adopted laws to prohibit the importation of wine and other alcoholic beverages except through a highly regulated system. The structure of the ABC system is a three-tiered system. Under this system, an out-of-state producer of wine may sell its products in North Carolina to licensed wholesalers only. Wholesalers may in turn sell the products to other wholesalers or to licensed retailers. Only licensed retailers may sell the products to consumers.

In 1981, the General Assembly enacted an exception to this three-tiered structure. Under that exception, North Carolina wineries were allowed to sell and ship wine directly to North Carolina consumers. This exception did not extend to out-of-state wineries. In 2002, a federal district court held in *Beskind v. Easley*,[38] that this exemption violated the Commerce Clause of the United States Constitution because it clearly favored in-state economic interests over out-of-state interests. The court further held that North Carolina's regulatory interests protected under the Twenty-first Amendment did not outweigh the federal government's interest in regulating interstate commerce in this instance. That court ordered the State not to enforce the ban on out-of-state shipments and to collect the excise tax due on the wine shipped from out of state. North Carolina appealed this decision to the federal Court of Appeals. That court upheld the holding that the exemption violates the Commerce Clause but allowed the General Assembly to fashion an appropriate remedy. *Beskind v. Easley*, 325 F.3d 506 (4th Cir., 2003). In essence, the General Assembly was left with the option of repealing the exemption for in-state wineries or allowing shipments from out-of-state wineries on the same basis as for in-state wineries.

This act establishes a structure through which out-of-state wineries, as well as in-state wineries, may ship wine directly to consumers in North Carolina. Under this act, any winery that holds a federal basic wine manufacturer permit may apply for a North Carolina wine shipper permit for a fee of $100. The annual renewal fee is $25.[39] The permit authorizes the shipment of brands of wine identified in the permit application. The wine shipper permittee may amend the brands identified in the permit at any time. The wine shipper permittee is required to notify any wholesale permittee that had been authorized to distribute those brands in this State of its application to become a wine shipper permittee. If the wine shipper permittee ships more than

[37] New Hampshire approved a $228 wine shipment permit on July 1, 1998, and had issued only 189 as of May 23, 2003.
[38] 197 F.Supp.2d 464 (W.D. NC, 2002).
[39] G.S. 18B-903 provides that ABC permits are valid for one year, May 1 to April 30, and that the renewal fee is 25% of the original application fee.

1000 cases[40] of wine to addresses in the State during a calendar year, the permittee is required to appoint a North Carolina wholesaler if any North Carolina wholesaler wishes to sell the products.[41] A winery would not be required to obtain a wine shippers permit to ship to addresses in North Carolina wine that was bought on the premises of the winery.

A wine shipper permittee may ship up to two cases of wine per month to any person in North Carolina to whom alcoholic beverages may be sold. Shipment of wine may be made by common carrier only. The common carrier is required to have the recipient demonstrate that he or she is over the age of 21 and sign an acknowledgement of receipt. The common carrier must refuse delivery when the recipient appears to be below 21 years of age and fails to provide sufficient identification.

The act also establishes a mechanism for collecting the excise[42] and use[43] taxes due on the wine. Under the prior law, the direct shipment of wine escaped the imposition of the State excise tax[44] because the tax was payable by the resident wholesaler or importer. Although the consumer is liable for the use tax due on the purchase of the wine, the winery shipping the wine had no affirmative duty to collect and remit the tax if it does not have nexus in this State. Under this act, a wine shipper is required to pay the excise tax due on the wine and to collect the use tax due on the wine. Under the Twenty-first Amendment to the United States Constitution, the State has more authority to regulate alcoholic beverages than it generally has to regulate interstate commerce. Because of the greater authority granted to states under the Twenty-first Amendment, it is not as difficult to establish nexus when the product to be taxed is an alcoholic beverage. Because the State would be requiring the out-of-state wineries to obtain a permit to ship to North Carolina addresses, the State would have sufficient nexus with the winery to force the collection of the taxes.

LOCAL OPTION PROJECT DEVELOPMENT FINANCING.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-403	**SB 725**	**Senator Clodfelter**

AN ACT TO AMEND THE NORTH CAROLINA CONSTITUTION TO PERMIT CITIES AND COUNTIES TO INCUR OBLIGATIONS TO FINANCE THE PUBLIC PORTION OF CERTAIN ECONOMIC DEVELOPMENT PROJECTS.

OVERVIEW: This act authorizes the voters of the State to vote in the November 2004 statewide general election on an amendment to the North Carolina Constitution that would allow

[40] A case is defined as any combination of packages that contains not more than nine liters of wine. Wine purchased by a resident of the State at the premises of the wine shipper permittee and shipped to an address in the State is not included in calculating the total of 1,000 cases.
[41] The wine shipper permittee does not have to appoint the wholesaler that originally contacted it to serve as its appointee.
[42] The excise tax on unfortified wine is 21¢ and the excise tax on fortified wine is 24¢.
[43] Wine is subject to a 4.5% State sales and use tax and a 2.5% local sales and use tax in every county but Mecklenburg County; in Mecklenburg County, the local sales and use tax is 3%.
[44] Although the State collects the excise tax, the State shares the revenues with the counties and cities in which the retail sale of wine is authorized in the entire county or city: these local governments receive 62% of the excise tax collected on unfortified wine and 22% of the tax collected on fortified wine.

local governments to finance development within defined districts by issuing tax increment financing bonds without a local referendum.

FISCAL IMPACT: This act has no fiscal impact on the General Fund. It could potentially result in a cost of $100,000 to the State Board of Elections, which will reimburse the counties for the cost of the required notices, advertisements, and publications concerning the statewide referendum. If the constitutional amendment passes, local governments would have additional revenues available to them through the use of this financing tool. *(For a more complete fiscal analysis, see the Overview: Fiscal and Budgetary Actions, 2003 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective when signed into law by the Governor on August 7, 2003. However, the proposed constitutional amendment to authorize local option project development financing will be subject to voter approval in a statewide general election in November 2004. If a majority of the votes are in favor of the amendment, then the amendment and the corresponding statutory changes would become effective upon certification of the constitutional amendment by the Secretary of State.

ANALYSIS:

Authorization for Local Option Project Development Financing

This act will permit the voters of the State to vote on a constitutional amendment that would allow the General Assembly to enact general laws authorizing counties, cities, and towns to borrow money, without voter approval, to finance the public portion of certain economic development projects within a defined territorial area.[45] This development tool, generally known as tax increment financing but referred to as "project development financing" in the act, would allow local governments to set aside the additional property taxes that are generated by a new investment to pay for public facilities that support that new investment.

The financing, issued in the form of bonds or other debt instruments, could be used for airports, auditoriums and arenas, hospitals, museums, parking facilities, sewer systems, storm sewers and flood control facilities, water systems, street improvements, public transportation facilities, railroads, affordable housing, land development for industrial or commercial purposes, utilities, and redevelopment. Redevelopment includes purchasing and improving property to help local redevelopment commissions. The bonds may also be issued for municipal service district projects.

Constitutional Amendment Required

The Constitution would have to be changed to allow project development financing because under the Constitution as it now reads the General Assembly does not have the power to authorize any unit of local government to issue bonds secured by its property tax revenue without a vote of the people. An amendment is also needed to allow property owners within the development area to agree to a minimum tax assessment on their property. The project development financing constitutional amendment will be placed before the voters in the next statewide general election, to be held in November 2004.

Development Financing District

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[45] A similar proposed constitutional amendment has been defeated by the voters twice before, on November 2, 1993, and November 2, 1982. In 1993, more than 78% of the voters voted against the constitutional amendment. It failed in every county except Northampton, where the vote was 1,253 for and 1,226 against.

If the amendment is approved, counties, cities, and towns could create a development financing district and adopt a development financing plan for that district. The total land area of the district may not exceed 5% of the total land area of the unit creating the district. The district also must be comprised of property that is one or more of the following:

- Blighted, deteriorated, deteriorating, undeveloped, or inappropriately developed from the standpoint of sound community development and growth.
- Appropriate for rehabilitation or conservation activities.
- Appropriate for the economic development of the community.

Development Financing Plan

The development financing plan describes the projects the unit of local government desires to finance and how the tax proceeds from the project development financing bonds will be used. The plan must include the costs of the proposed public activities, the sources and amounts of funds to pay for the proposed public activities, the base valuation of the district, the projected incremental valuation of the district, and the estimated duration of the district. The plan must also include a description of how the proposed development, both public and private, will benefit the residents and business owners of the district in terms of jobs, affordable housing, and services. The plan must contain a requirement that initial users of a new manufacturing facility located in the district pay employees of the facility an average weekly manufacturing wage that is either above the average weekly manufacturing wage paid in the county where the district is located or is at least 10% above the average weekly manufacturing wage paid in the State. A plan may be exempt from the wage requirement if the Secretary of Commerce finds that unemployment in the county in which the district is located is especially severe.

Before adopting a plan for a development financing district, the unit of local government must do all of the following:

- If the unit is a city, town, or incorporated village, send notice of the plan to the board of county commissioners, which has 28 days after the date the notice is mailed to disapprove the plan. The unit may proceed with the plan unless the county disapproves it within 28 days.
- Submit the plan to the Secretary of Environment and Natural Resources for review to determine if the construction and operation of any new manufacturing facility will have a materially adverse effect on the environment and whether the company operating the facility has operated in substantial compliance with environmental requirements.
- Hold a public hearing on the plan after providing public notice, including written notice to all property owners within the proposed district.

Approval by Local Government Commission

If a local government wants to issue project development financing bonds to finance the public portion of economic development projects within a development financing district, it must have the approval of the Local Government Commission. The Commission cannot approve an application until the development financing plan is adopted. Before approving the bond issuance, the Commission must find, among other things, that the proposed project development financing bond issue is necessary to secure significant new project development for a development financing district and that the private development forecast in the development financing plan would likely not occur without the public projects to be financed by the bonds.

The Commission must also find that the taxes on the incremental valuation, together with any proceeds that may be realized from the sale of property in the district and any revenues that may be realized from a public facility in the district, will be sufficient to service the project development financing bonds.

Determination of Base Value and Incremental Value

Once the district has been established and the project development financing debt instruments have been approved by the Local Government Commission, the local government unit must notify the county tax assessor who must determine the base valuation of the district. The base valuation is the assessed value of all taxable property located in the district on the January 1 immediately preceding the effective date of the district. The base valuation may be adjusted if property is removed from or added to the district. Each year the development financing district is in existence, the tax assessor must determine the current assessed value of taxable property located in the district. The assessor must also compute the difference between this current value and the base valuation of the district. If the current value exceeds the base value, the difference is the incremental valuation of the district.

Security for Bonds

The tax assessor must establish a separate fund, known as the Revenue Increment Fund, to account for the proceeds paid to the unit from taxes levied on the incremental valuation of the district. After certain deductions are made from the Fund and transferred to the local government unit, any remaining money in the Fund may be used to finance capital expenditures in the district, to meet principal and interest requirements on project development financing debt instruments, to repay moneys expended on debt service on project development financing debt instruments, and to establish and maintain debt service reserves.

To provide additional security for the bonds, the unit of local government issuing the bonds may pledge the proceeds from the sale of property in the development financing district and the net revenues from public facilities in the development financing district constructed or improved under the development financing plan. The unit of local government may also pledge any other available sources of revenue as long as the agreement to use the sources to make payment does not constitute a pledge of the unit's taxing power. Other available sources of revenues that do not constitute a pledge of a local government's taxing power include taxes levied by the State that are transferred to the local government, such as beer and wine tax revenues, utilities franchise tax revenues, and intangibles tax revenues.

The unit of local government may also enter into agreements with the owners of real property in the development financing district for which the bonds were issued under which the owners agree to a minimum value at which their property will be assessed for taxation. Such an agreement may extend for the life of the development financing district or for a shorter period agreed to by the parties. The agreement may vary the agreed-upon minimum assessed value from year to year. The purpose of such an agreement is to provide additional security for the bonds by assuring that the property tax base in the district would not fall below a certain level.

Duration of District and Term of Bonds

The district may remain in effect for 30 years or until the bonds are retired. The bonds must be retired within 30 years or within the useful life of the projects financed, whichever is shorter. After that, all taxes are paid into the local general fund.

ESC SURTAX DELAY.

Session Law	Bill #	Sponsor
S.L. 2003-405	**HB 1241**	**Representative Luebke**

AN ACT TO DELAY THE REINSTATEMENT OF THE TWENTY PERCENT UNEMPLOYMENT INSURANCE SURTAX.

OVERVIEW: The purpose of S.L. 2003-405 is to defer imposition of the 20% surtax on employer unemployment insurance contributions if, as of August 1 of the preceding year, the balance in the State Unemployment Insurance Fund is $500 million or less. The delay of the surtax applies only to the 2004 tax year.

FISCAL IMPACT: The State General Fund is not affected. Only the Reserve Fund in the unemployment insurance system will be affected. *(For a more complete fiscal analysis, see the Overview: Fiscal and Budgetary Actions, 2003 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The act became effective when signed into law by the Governor on August 12, 2003, and is repealed for taxes imposed in the 2005 and subsequent calendar years.

ANALYSIS: Unemployment insurance taxes or contributions are paid by employers on a quarterly basis and deposited into the Unemployment Insurance Fund. Pursuant to G.S. 96-6, the Unemployment Insurance Fund is administered by the Employment Security Commission, and disbursed by the State Treasurer under the direction of the Commission. The following three separate accounts are maintained within the Fund: a clearing account, an unemployment trust fund account, and a benefit account. The moneys payable to the Fund are initially deposited in the clearing account. After deducting any refunds payable from the Fund pursuant to G.S. 96-10(f), the money is deposited with the secretary of the treasury of the United States to the credit of this State's account in the unemployment trust fund.[46] Funds in the State's account earn interest that is also credited to the account. As money in the State's account is needed to pay benefits, it is transferred to the State and credited to the benefits account of the State Unemployment Insurance Fund to be used to pay benefits to people who lose their job through no fault of their own. Federal law prohibits transfer of or payment of refunds from money in the unemployment trust fund account.

There is also an Employment Security Commission Reserve Fund, created in the State treasury, and used by the Commission to bolster the Unemployment Insurance Fund. The moneys in the Reserve Fund consist of proceeds from the 20% surtax on contributions due.[47] This surtax was suspended in 1992, but the surtax is automatically triggered when the balance of the Reserve Fund falls below $163 million. Also, under G.S. 96-9(b)(3)d5, the regular unemployment insurance tax or contribution rate of an employer is reduced by 50% for any year in which the balance in the Unemployment Insurance Fund equals or exceeds $800 million. After a number of years paying the contributions at the 50% rate, employers began paying at the full rate in 2003. The tax will remain at the full rate until the Unemployment Insurance Fund again reaches $800 million, thereby triggering the half rate.

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[46] G.S. 96-10(f) provides for the refund of contributions if a court determines that the contributions were invalid, excessive, or contrary to the provisions of Chapter 96 of the General Statutes.

[47] G.S. 96-5(f) provides that the moneys in the Reserve Fund may be used by the Commission for loans to the Unemployment Insurance Fund, as security for loans from the federal Unemployment Insurance Trust Fund, and to pay any interest required on advances under Title XII of the Social Security Act.

S.L. 2003-405 states that the 20% surtax will not be imposed as long as the Unemployment Insurance Fund balance is at or below $500 million. When the contributions replenish the Fund balance to $500 million, then the 20% surtax will be triggered to start refilling the Reserve Fund. When the Reserve Fund reaches $163 million, the surtax will trigger back off. The intended effect is that the 20% surtax, originally scheduled to go into effect January 1, 2004, because the balance in the Reserve Fund is under $163 million, will not be imposed during the 2004 calendar year.

QUALIFIED BUSINESS CREDIT/PORTS CREDIT.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-414	**HB 1294**	**Representative G. Allen**

AN ACT TO EXPAND THE QUALIFIED BUSINESS INVESTMENTS TAX CREDIT AND TO EXTEND THE SUNSET ON THE STATE PORTS TAX CREDIT.

OVERVIEW: This act does the following:

- Extends the sunset on the State Ports Tax Credit from 2004 to 2009.
- Amends the Qualified Business Investment Tax Credits to:
  - Extend the sunset from 2004 to 2007.
  - Expand the definition of a qualified grantee business to include those that receive grants from entities such as MCNC-Research and Development Institute, a nonprofit corporation formed to enhance economic development in North Carolina through applied research and technology development and commercialization of these technologies.
  - Add a new type of qualified business: a small business that is commercializing technology developed by a research university.

FISCAL IMPACT: The extension of the sunset on the Qualified Business Investment Tax Credit will cost the General Fund an estimated $6 million a year beginning in 2005-2006. The extension of the State Ports Tax Credit will cost the General Fund an estimated $650,000 a year beginning in 2004-2005. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2003 Session. Available in the Legislative Library.)*

EFFECTIVE DATES: The portions of the act dealing with the qualified business venture tax credits became effective for taxable years beginning on or after January 1, 2004. The portion of the act dealing with the State ports tax credit became effective when the act was signed into law by the Governor on August 14, 2003.

ANALYSIS:

Qualified Business Tax Credits

The qualified business investment tax credit is allowed for an individual taxpayer who purchases the equity securities or subordinated debt of a qualified business venture or a qualified grantee business directly from that business. The credit is equal to 25% of the amount invested and may not exceed $50,000 per individual in a single taxable year. An individual investor may also claim the allocable share of credits obtained by "pass-through entities" of which the investor is an owner. Pass-through entities include limited partnerships, general partnerships, S

corporations, and limited liability companies. The credit may not be taken in the year the investment is made. Instead, the credit is taken in the year following the calendar year in which the investment was made, but only if the taxpayer filed an application with the Secretary of Revenue. Any unused credit may be carried forward for the next five years. The total amount of credits allowed to all taxpayers for investments made in a calendar year may not exceed $6 million. The Secretary of Revenue calculates the total amount of tax credits claimed from applications filed with the Secretary of Revenue. If the amount exceeds the cap, then the Secretary allows a portion of the tax credits claimed by allocating the total of $6 million in tax credits in proportion to the size of the credit claimed by each taxpayer. In general, a taxpayer forfeits the credit if the taxpayer transfers the securities within one year or the qualified business redeems the securities purchased by the taxpayer within five years after the investment was made.

Qualified business tax credit sunset. – The qualified business investment tax credit was enacted in August 1987 to promote economic development for North Carolina businesses. The original credits applied to both corporations and individual taxpayers, and there was a $12 million cap on the total amount of all tax credits. In response to a 1996 United States Supreme Court decision in *Fulton Corp. v. Faulkner*, 516 U.S. 325, (1996), which raised the issue of whether the credits unconstitutionally discriminated against out-of-state businesses, the General Assembly reduced the $12 million cap to $6 million, removed the requirement that the qualified businesses be headquartered or operating in North Carolina, and limited the credit to individuals and small pass-through entities. The latter change was based on the theory that these investors are not likely to invest outside a 50-mile radius of their homes.

One of the purposes of the sunset was to determine if the credit is being allowed for investments in non-North Carolina businesses. Because the Constitution does not allow the credit to be restricted to North Carolina businesses, there is the possibility that North Carolina tax dollars may actually be subsidizing investments in out-of-State corporations. The Secretary of State's Office is required to publish a periodic list of businesses that have registered as qualified businesses. The most recent version of this list indicates that most registered businesses are North Carolina businesses.

This act extends the sunset on the qualified business tax credit from January 1, 2004 until January 1, 2007. The credit was originally set to expire for investments made on or after January 1, 1999. In 1998, the credit was extended for four additional years until January 1, 2003. Then, in 2002, it was extended for one additional year, until 2004.

Expand types of qualified businesses. – Under current law, in order to be a business in which investments are eligible for a credit, the business must be either a *qualified business venture* or a *qualified grantee business*. Both types of businesses must be registered with the Secretary of State. The definition of *qualified business venture* includes several general requirements related to the line of business, gross revenues of the business, and the organization date of the business. A *qualified grantee business* is one that has received a grant or other funding in at least one of the three previous years from one of several types of entities that are generally described in the statute. Those descriptions would encompass the following entities that, before 2002, were specifically named in the statute: the North Carolina Biotechnology Center, MCNC, and the Kenan Institute for Engineering, Technology, and Science.

This act further expands one of these descriptions, which currently applies to nonprofits organized to stimulate microelectronics and communications industries, to also apply to nonprofits and their affiliates organized to conduct research and development in, or stimulate the development of, technologies. This language is designed to bring in a new entity called

MCNC-Research and Development Institute, which is a nonprofit corporation formed to enhance economic development in North Carolina through applied research and technology development and commercialization of these technologies. The new language will also cover the MCNC Enterprise Fund, which is owned 50% by MCNC and 50% by MCNC-RDI.

Additional type of qualified business. – This act also adds a third category of qualified businesses: a *qualified licensee business*. These businesses must have no more than $1 million in gross revenues annually and must be performing under a contract with a UNC system institution or a doctoral research university to commercialize technology developed by the institution or university.

State Ports Tax Credit

The State Ports tax credit is allowed to a taxpayer who loads or unloads waterborne cargo from an ocean carrier at the State-owned port terminal at Wilmington or Morehead City. The credit is allowed against the taxpayer's income tax. The taxpayer may be either an individual (G.S. 105-151.22) or a corporation (G.S. 105-130.41). The amount of the tax credit is equal to the amount of wharfage, handling, and throughput charges paid to the North Carolina State Ports Authority in the taxable year that exceeds the average amount of charges paid to the Authority for the current tax year and the two previous tax years. The credit is limited to 50% of the tax imposed on the taxpayer for the taxable year. Any excess credit may be carried forward and applied to the taxpayer's income tax liability for the next five years. The maximum cumulative credit that one taxpayer may claim is $2 million.

In 1992 the General Assembly enacted the State Ports tax credit to encourage exporters to use the two State-owned port terminals in Wilmington and Morehead City. When enacted, the credit applied to amounts paid by a taxpayer on any cargo exported at either port. In 1994, the General Assembly expanded the credit to include all amounts assessed on exported cargo, regardless of who paid the shipping costs. In 1995, the General Assembly expanded the credit to include some imports by allowing a credit for break-bulk cargo and container cargo imported at either Wilmington or Morehead City and for bulk cargo imported at Morehead City. It did not allow a credit for bulk cargo imported at Wilmington. In addition, the credit for bulk exports was then limited to bulk exports at only the Morehead City terminal. In 1996, the General Assembly expanded the State Ports tax credit to include the importing and exporting at either terminal of one specific type of bulk cargo: forest products. All imports and exports of bulk cargo at the Morehead City terminal were already covered, so the effect of this change was to allow a credit for forest product imports and exports at the Wilmington terminal. In 1997, the General Assembly increased the maximum cumulative credit from $1 million to $2 million per taxpayer.

Although not defined by the relevant statutes, the various types of cargo differ as follows:

- ☐ Bulk cargo is a type of commodity that is loose and usually stockpiled. Typically, bulk is considered material that is picked up in "scoops" and not in a bag or some other type of binding. Examples of this type of commodity include cement, coal, fertilizer, fishmeal (used for making pet food), grain, salt, sand (used for golf courses and during ice storms), soybean meal, and wood chips.
- ☐ Break-bulk cargo consists of commodities that are packaged and stored on pallets or in cases that must be handled and stacked onto a ship by hand, crane, etc. Break-bulk cargo also includes machinery. Some examples of break-bulk cargo include cotton, lumber, paper, and rubber.

- ☐ Container cargo consists of commodities that are packaged in a metal trailer box that can be locked onto a tractor-trailer chassis and then detached and put on a ship without any other handling. Some examples of container cargo include clothing, electronics, frozen poultry, furniture, housewares, meat, seafood, and tobacco.

When first enacted, this credit was to sunset for taxable years ending on or before February 28, 1996. In 1995, the General Assembly extended the sunset date to February 28, 1998. In 1997, the General Assembly extended the sunset date to February 28, 2001. In 2001, the General Assembly extended and conformed the sunset to apply to taxable years beginning on or after January 1, 2003. In 2002, the General Assembly extended the sunset date to January 1, 2004. This act extends the sunset for five years, to January 1, 2009.

EXPAND HISTORIC PRESERVATION CREDIT.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-415	**SB 119**	**Senator Horton**

AN ACT TO EXPAND THE TAX CREDITS FOR HISTORIC REHABILITATION BY EXTENDING THE SUNSET ON A PROVISION ALLOWING A PASS-THROUGH ENTITY TO ALLOCATE AMONG ITS OWNERS THE TAX CREDIT FOR INCOME-PRODUCING STRUCTURES AND INCREASING THE AMOUNT THAT MAY BE ALLOCATED TO AN OWNER UNDER THIS PROVISION.

OVERVIEW: This act amends the historic preservation tax credit as follows:

- It extends the sunset on the provision that permits a pass-through entity to allocate among its owners the tax credit for income-producing property from January 1, 2004, to January 1, 2008.
- It amends the above-described provision to permit a pass-through entity to allocate the credit to an owner if an owner's adjusted basis in the pass-through entity is at least 40% of the amount of the credit allocated to that owner.

The act also directs the Department of Revenue to modify the income tax forms to provide separate lines for each tax credit claimed by the taxpayer.

FISCAL IMPACT: No estimate can be made of the actual revenue impact of this act. The changes made by this act are intended to increase the likelihood that the historic rehabilitation credits will be fully utilized by taxpayers. However, the General Assembly's Fiscal Research Division has assumed since 1997, the year the credit was increased to 20%, that 100% of the tax credits have been used and has built into the General Fund availability forecast 100% utilization of the historic credit. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2003 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective when signed into law by the Governor on July 10, 2003. The 2003 individual income tax forms will be modified according to the provisions of this act.

ANALYSIS: North Carolina allows an income tax credit[48] to taxpayers that qualify for the federal historic rehabilitation tax credit.[49] The amount of the credit is equal to 20% of the expenses of rehabilitating an income-producing historic structure.[50] A pass-through entity may qualify for the rehabilitation credit and pass the credits on to its owners.[51]

For most State tax credits, a pass-through entity is required to allocate the credit among its owners in the same proportion that other items, such as the federal rehabilitation credit, are allocated under the Internal Revenue Code. Under the Internal Revenue Code, tax credits are allocated among S corporation shareholders in accordance with their pro rata share of the corporation, which is determined on the basis of stock ownership,[52] and tax credits are allocated among partners in a partnership in accordance with the partnership agreement.[53] However, in 1999, the General Assembly amended the law to provide for the separate sale of the historic tax credit for income-producing property by allowing a pass-through entity to allocate the tax credit among its owners at its discretion. The allocation of the credit allows the tax credit to be utilized more fully since it can be redistributed to North Carolina investors with State income tax liability. Each year an allocated credit is claimed, the pass-through entity and its owners must include a statement with their tax return that shows both the allocation made and the allocation that would otherwise have been required under G.S. 105-131.8 and G.S. 105-269.15. This change in the law would have expired for taxable years beginning on or after January 1, 2002. S.L. 2001-476 extended the provision for two years and this act extends it for four more years, until January 1, 2008.

To further maximize the use of the State historic rehabilitation tax credit for income-producing property, this act increases the amount of the credit that a pass-through entity may allocate among its owners. Prior law provided that the credit could be allocated to an owner of the pass-through entity, as long as the amount of the credit allocated to the owner did not exceed the owner's adjusted basis in the entity,[54] as determined under the Code. This act provides that the owner's adjusted basis must be at least 40% of the credit allocated to that owner. The General Assembly enacted a similar change in the low-income housing tax credit in 2002.[55]

During the finance committee deliberations, the Department of Revenue was asked to report on the amount of income-producing historic rehabilitation tax credits taken in tax years 2000 and

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[48] G.S. 105-129.35. The credit may not be taken for the tax year the property is placed in service but must be taken in installments over five years after the historic structure is placed in service. Any unused portion of a credit may be carried forward for a five-year period.

[49] The federal tax credit is available for rehabilitating only income-producing historic structures. The federal credit amount is equal to 20% of the rehabilitation expenses.

[50] North Carolina also allows an income tax credit of 30% of the expenses of rehabilitating an historic structure that is not income-producing, and thus not eligible for the federal income tax credit.

[51] A pass-through entity is an entity, such as a partnership, a limited liability company, or a Subchapter S corporation, that is treated as owned by individuals or other entities under federal tax law and whose income, losses, and credits are reported by the owners on their State income tax returns.

[52] State law provides that the tax credit allowed a shareholder in a Subchapter S corporation is based on the percentage of stock held by the shareholder in the corporation. G.S. 105-131.8.

[53] State law provides that the tax credit allowed a partner is based on the partnership agreement, which must have substantial economic effect, which means that the allocation agreement must reflect the economic interest of the partners in the partnership and cannot be based solely on tax consequences. G.S. 105-269.15.

[54] The adjusted basis is determined at the end of the taxable year in which the historic structure is placed in service.

[55] S.L. 2002-87.

2001. Although the Department could extrapolate from outside data the amount of tax credits taxpayers were eligible for each year, it could not determine the percentage of tax credits actually claimed each year. The Department's Tax Research Division responded that it could only determine the number of corporate taxpayers that claimed the historic rehabilitation credit because the agency's computer system does not contain information on the individuals that claim the credit. The computer system does not capture data on individual historic rehabilitation credits because the credit is one of a number of credits combined on Form D-400TC as a miscellaneous credit. To remedy this data problem, the act directs the Department of Revenue to change the income tax forms to provide separate lines for each tax credit claimed by a taxpayer, effective for tax years beginning on or after January 1, 2003. This change will provide valuable information to legislative and executive branch analysts tasked with evaluating and estimating the General Fund revenue loss of tax credits.

REVENUE LAWS TECHNICAL CHANGES.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-416	**SB 97**	**Senator Hartsell**

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

OVERVIEW: This act makes technical and clarifying changes to the revenue laws and related statutes.

FISCAL IMPACT: No fiscal impact.

EFFECTIVE DATE: Section 27, which modifies a distribution of local sales tax revenue initially included in the 2003 Budget Act, becomes effective October 1, 2003. The remainder of the act became effective when signed into law by the Governor on August 14, 2003.

ANALYSIS: S.L. 2003-416 makes technical and clarifying changes to the revenue laws and related statutes, as outlined in the following chart:

Section	Explanation
1 & 3	Section 1 clarifies that the 2002 law modifying the estate tax formula for estates with property in more than one state does not apply to the extent it would create a retroactive increase for estates of decedents dying between January 1, 2002, and the date the act became law. Sections 1 and 3 clarify the effective date of the low-income housing tax credit.
2	Re-enacts a session law that did not receive three roll-call readings on adoption of the conference report.
4	Moves the definition of "pass-through entity" to the general definitions section and makes appropriate cross-reference changes.
5	Modernizes terminology by changing the word "business" to "apportionable" as it relates to the apportionment of corporate income tax.
6	Corrects capitalization.
7	Makes a grammatical change.

Section	Explanation
8	Clarifies that interest, not the interest rate, for the low-income housing tax credit is computed from the date the Secretary transferred the credit amount to the Housing Finance Agency.
9	Makes a punctuation change.
10	Clarifies that the entire penalty may be waived for the nonpayment of taxes. G.S. 105-357(b)(2) imposes a penalty for nonpayment of taxes of the greater of 10% or $25. However, the prior wording of G.S. 105-358(a) authorized waiver of only the 10% penalty.
11	Supplies missing language.
12	Clarifies that the North Carolina Constitution prohibits the General Assembly from contracting away its taxing power.
13	Conforms effective date language to reflect that adoption of the Streamlined Sales Tax Agreement may be other than by signature.
14	Conforms local law relating to local sales tax distribution to reflect additional local option sales tax enacted in 2001.
15	Undoes drafting error that substituted for a stock ownership test the similar requirements for controlled group membership. The substituted language is not workable because, unlike the stock ownership test, it does not cover non-corporate entities. This corrects a definition in the statute dealing with royalty income reporting option.
16	Conforms terminology to reflect definition changes enacted in 2002.
17	Restores a provision that was deleted in 1997.
18	Conforms sales tax exemption and refund statutes to reflect that exemptions and refunds extend to some taxable services.
19	Sets out in statute the prohibition against levying the scrap tire, white goods, or dry-cleaning solvent tax on sales the State cannot constitutionally tax.
20	Deletes a provision regarding the property tax value of cotton. The provision is obsolete because cotton is covered by the exemption for inventories.
21	Corrects a cross-reference.
22	Adds "G.S." before a statutory citation.
23	Corrects name of UNC Health Care System.
24	Amends the captions to fit the text of the statutes.
25	Clarifies that the conflict of interest language applies to current members as well as former members of the Economic Investment Committee. This committee administers the Job Development Investment Grant Program.
26	Corrects an effective date for a section of the streamlined provisions in the 2003 Budget Act.

Section	Explanation
27	Revises the distribution formula for the local sales tax on food effective October 1, 2003, as requested by the NC League of Municipalities and the NC Association of County Commissioners. The modified distribution formula will more accurately reflect the current distribution of those revenues. (*For a more detailed explanation of the distribution, see the summary for S.L. 2003-284, 2003 Budget Act)*
28	Allows a one-time withholding of $25,000 from the local taxes collected on food in order to cover the Department of Revenue's programming costs associated with the distribution of the local taxes collected on food.
29	The 2003 Budget Act transferred all receipts of the Wireless 911 Fund for the 2003-04 fiscal year (estimated at $33 million) and $25 million of the receipts for the 2004-05 fiscal year to the General Fund. Subsection (a) of this section limits that transfer for the 2003-04 fiscal year to $33 million, or the actual fund receipts for 2003-04 less the 1% administrative fee the Wireless 911 Board is authorized to deduct, *whichever is less*. Subsection (b) of this section amends a provision allowing the Wireless 911 Board to reallocate the 60-40% split between the wireless phone service providers and the 911 centers. Prior law allowed that reallocation by the Board when it adjusts the service charge, with the reallocation affecting the subsequent receipts. The amendment allows the reallocation at any time, and allows the reallocation to affect money already in the Fund balance, as well as subsequent receipts. This change allows the Board greater flexibility to meet the financial needs of the wireless providers and the 911 centers as the wireless 911 system is deployed in accordance with the FCC order and in light of the diversion of Wireless 911 Fund receipts in the 2003-05 biennium. When fully deployed, the wireless 911 system will allow automatic location of a person calling 911 with a wireless phone.
30	Section 27 becomes effective October 1, 2003. The remainder of the act became effective when it became law, August 14, 2003.

ECONOMIC DEVELOPMENT DISTRICT.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-418	**SB 168**	**Senator Smith**

AN ACT TO PROVIDE FOR THE CREATION OF ECONOMIC DEVELOPMENT AND TRAINING DISTRICTS.

OVERVIEW: This act authorizes counties to create special tax areas under Section 2(4) of Article V of the North Carolina Constitution. These areas, called economic development and training districts, would be for the purpose of providing a skills training center to prepare county residents to perform manufacturing, research and development, and related service and support jobs in the pharmaceutical, biotech, life science, chemical, telecommunications, and electronics industries. A county may levy property taxes within the district, in addition to those levied throughout the county, in order to finance the skills training center.

The act also defines the property that may be initially included within an economic development and training district located in Johnston County should the board of commissioners of Johnston County elect to establish one. The act states that a municipality cannot annex property within a district located in Johnston County.

FISCAL IMPACT: This act does not affect State revenues.

EFFECTIVE DATE: This act became effective when signed into law by the Governor on August 14, 2003.

ANALYSIS: Section 1 of the act adds a new Part to the county service district Article in Chapter 153A of the General Statues. It authorizes a county to establish an "economic development and training district." Such a district would be a special tax area pursuant to Section 2(4) of Article V of the North Carolina Constitution. That section authorizes the General Assembly to enact general (statewide) laws giving local governments the authority to establish these areas. A local act would be unconstitutional.

The new law applies statewide but the conditions imposed for creation of a district are so specific that the law is unlikely to apply anywhere but in the intended location, Johnston County. These conditions include the requirement that all of the property in the district be used for specific types of manufacturing, including at least two pharmaceuticals manufacturing or bioprocessing facilities with sites aggregating at least 425 acres owned by publicly held corporations. In addition, the district must include an industrial park of at least 60 acres within a noncontiguous 625-acre parcel now or formerly owned by an airport authority. Section 2 of the act provides that no municipality may annex, other than by voluntary annexation, any property in Johnston County that is located within an economic development and training district. Section 2 of the act also provides that if the board of commissioners of Johnston County elect to establish an economic development and training district, then the district as initially established will consist of certain described real property owned by Bayer Corporation, Novo Nordisk Pharmaceutical Industries, Inc., Fresenius Kabi Clayton, L.P., and the Johnston County Airport Authority.

There are three stated purposes for an economic development and training district: (1) to finance and maintain a skills training center to prepare local residents to perform jobs related to the types of industries within the district; (2) to provide education and related services and facilities; and (3) to provide economic development in the county. The act authorizes the county to levy property taxes within the district at a rate of up to 8¢ per $100 to provide the skills training center, but does not authorize the levy of property taxes for the other two purposes of the district. It goes on, however, to state that the proceeds of the district taxes may be used to pay annual debt service on the skills training center of up to $1.2 million and also to pay "any other services or facilities" provided in response to a recommendation of an advisory committee required to be set up to represent district property owners as well as the county.

The act provides the following procedural requirements relating to an economic development district:

- Creation of District. – Before a district can be created, there must be presented to the board of commissioners a petition signed by the owners of real property in the district representing at least 50% of the total assessed value of real and personal property in the district. Before establishing a district, the county must provide notice to the public and to affected property owners, prepare a report including a map and a plan for the district, hold a public hearing, and make findings that support the need for the district.

- Advisory Committee. – In the resolution establishing an economic development and training district, the board of commissioners must create a five-member advisory committee with three members representing an association of owners and tenants in the district and two members representing the county. The purpose of the committee is to make recommendations to the county on the type and level of services, facilities, or functions to be provided for the district.
- Enlargement of District. – The board of commissioners would be authorized to annex territory to the district subject to conditions and procedural requirements similar to those that apply to establishing the district. If any of the area proposed to be annexed is within the extraterritorial jurisdiction of a municipality, then a majority of the members of the governing body of the municipality must vote in favor of annexation.
- Abolition of District. – The board of commissioners may abolish a district if there is no longer a need for the district and the board has received a petition requesting abolition signed by at least 50% of real property owners in the district who own at least 50% of the real and personal property in the district. There must be notice and a public hearing prior to the adoption of a resolution abolishing a district.

STATE GOVT SALES TAX EXEMPT/SCH COOP REFUND.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-431	**SB 100**	**Senator Kerr**

AN ACT TO PROMOTE EFFICIENCY IN STATE GOVERNMENT BY ALLOWING A SALES AND USE TAX EXEMPTION FOR STATE AGENCIES INSTEAD OF A SALES AND USE TAX REFUND TO STATE AGENCIES AND TO ALLOW A SALES AND USE TAX REFUND TO SCHOOL BOARD COOPERATIVES.

OVERVIEW: This act allows a sales and use tax exemption, instead of a sales and use tax refund, for purchases by State agencies. The act also allows a refund of State and local sales and use taxes by a joint agency created by interlocal agreement among local school administrative units to jointly purchase food service-related materials, supplies, and equipment on their behalf.

FISCAL IMPACT: The primary impact of the legislation on expenditures is the reduction in agency budgets to reflect the sales tax exemption. The act requires the Office of State Budget and Management to reduce each agency's certified budget by an amount that will offset the reduction to the General Fund from the loss of sales tax revenue. Some organizational efficiencies are also expected. Therefore, the net impact of the act is no significant change to the General Fund.

The annual revenue loss associated with the second part of the bill, which authorizes a refund of state and local sales tax for school board cooperatives, is expected to be less than $20,000 annually. However, no impact is expected until FY 2004-05. *(For a more complete fiscal analysis, see the Overview: Fiscal and Budgetary Actions, 2003 Session. Available in Legislative Library.)*

EFFECTIVE DATE: The exemption from State and local sales tax for State agencies becomes effective July 1, 2004. The refund of State and local sales and use taxes for school board cooperatives became effective for taxes paid on or after July 1, 2003.

ANALYSIS:

State Government Exemption

Currently, all major State agencies except the Department of Transportation[56] are subject to State and local sales taxes. However, the State receives a quarterly refund of the local sales taxes paid by its agencies[57] with the proceeds of the refund going to the General Fund.

The current refund process is time-consuming for the Office of the State Controller, the agencies, and the Department of Revenue. To relieve the agencies of this burden, the Office of the State Controller recommended changing the refund process to a sales and use tax exemption for State agencies.[58] The term "State agency" is currently defined for sales and use tax purposes as a unit of the executive, legislative, or judicial branch of State government, such as a department, commission, board, council, or The University of North Carolina. The term does not include local boards of education[59] or local boards of trustees for the community college system.

This act changes the current refund process to an exemption for State agencies. To qualify for the exemption, the items must be purchased by a State agency and the purchase must meet one of the following conditions:

- The items are purchased pursuant to a purchase order of the State agency that contains the exemption number of the agency and a description of the items purchased.
- The items purchased are paid for by a State-issued check, electronic deposit, credit card, procurement card, or credit account of a State agency and the agency provides to or has on file with the retailer the agency's exemption number.

The act incorporates all of the various payment and purchase mechanisms where accounting system controls are in place to verify purchases and prevent possible misuse of the agency's sales tax exemption by its employees. The only type of direct purchases not included within this exemption is employee expense reimbursements.

The sales tax exemption applies only to direct purchases of tangible personal property. State agencies will continue to apply for refunds of local taxes paid on indirect purchases of building materials, supplies, fixtures, and equipment that become a part of a structure owned or leased by the State.

A State agency will be liable for items purchased with its exemption number that it does not use. The liability will include not only the tax that should have been paid on the items purchased, but also interest calculated from the date the tax would otherwise have been paid.

To be eligible for the sales and use tax exemption, a State agency must obtain from the Department of Revenue a sales tax exemption number through an application process. The part

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[56] The Department of Transportation is exempt from State and local sales and use tax.

[57] Each State agency is suppose to file with the Secretary of Revenue a written application for a refund of the local sales taxes paid by it. The application is due within 15 days after the end of each calendar quarter. *G.S. 105-164.14(e)*.

[58] Refunds for purchases by the North Carolina Low Level Radioactive Waste Management Authority, the North Carolina Hazardous Waste Management Commission, the constituent institutions of the University of North Carolina paid for with contract and grant funds, and The University of North Carolina Hospitals at Chapel Hill are made on an annual basis and are refunded directly to the state agency. The act does not change the refund status of these purchases at the suggestion of the Office of State Budget and Management.

[59] Local school administrative units are allowed an annual refund of State and local sales taxes paid.

of the act that provides for this application process becomes effective January 1, 2004, so that State government agencies can begin the process of obtaining their exemption certificates from the Department of Revenue. The section of the act granting the exemption becomes effective July 1, 2004, and applies to sales made on or after that date.

The act also provides that the Office of State Budget and Management must reduce each State agency's certified budget for fiscal years 2003-04 and 2004-05 by an appropriate amount to reflect the tax savings generated by the sales and use tax exemption allowed under this act.

Sales Tax Refund for School Board Cooperatives

Under Chapter 160A of the General Statutes, units of local government[60] may enter into contracts or agreements with each other in order to execute any undertaking. Since 1996, several boards of education in the eastern part of the State have participated in an agreement under the authority of Part 1 of Chapter 160A in order to operate a cooperative program known as the Southeast Cooperative Utilizing Resources Efficiently (SECURE). The purpose of SECURE is to coordinate the acquisition of food service-related materials, supplies, equipment, and services. The school districts in SECURE now are Wayne, Pitt, Greene, Lenoir, Onslow, Sampson, New Hanover, Guilford, and Cumberland Counties.

Local school boards are allowed to seek an annual refund of State and local sales and use taxes. Since SECURE serves as a conduit for several local school boards to join together to increase their buying power, it applied for a sales tax refund on behalf of the school boards. However, the Department of Revenue found that it was not included in the list of entities entitled to a refund: SECURE is not a local board of education and it is not a charitable nonprofit organization.

This act allows SECURE and any other joint agency created by interlocal agreement among local school administrative units to jointly purchase food service-related materials, supplies, and equipment on their behalf to qualify for an annual refund of State and local sales and use taxes paid by it. The refund request must be made in writing and must include any information and documentation required by the Secretary. This section of the act became effective for taxes paid on and after July 1, 2003.

JOB GROWTH & INFRASTRUCTURE ACT.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-435	**HB 2 2nd Extra Session**	**Rep. G. Allen**

AN ACT TO MAKE THE FOLLOWING CHANGES RECOMMENDED BY THE GOVERNOR: (1) APPROPRIATE TWENTY-FOUR MILLION DOLLARS FOR INDUSTRIAL SITE INFRASTRUCTURE FOR MAJOR PROJECTS; (2) MODIFY THE JOB DEVELOPMENT INVESTMENT GRANT PROGRAM; (3) PROVIDE INCENTIVES FOR MAJOR PHARMACEUTICAL AND BIOPROCESSING FACILITIES BY EXTENDING THE BILL LEE ACT SUNSET FOR THESE INDUSTRIES AND AUTHORIZING SALES TAX REFUNDS FOR CONSTRUCTION MATERIALS FOR THESE INDUSTRIES; (4) EXTEND THE SUNSET ON AND MODIFY THE CIGARETTE EXPORTATION TAX CREDIT AND MODIFY THE BASE YEAR, (5)

[60] G.S. 160A-460 includes a local board of education within its definition of "unit of local government."

CREATE AN ENHANCED TAX CREDIT FOR CIGARETTE EXPORTATION, AND (6) CREATE A LIFE SCIENCES REVENUE BOND AUTHORITY.

OVERVIEW AND EFFECTIVE DATES: makes the following economic development changes:

- Appropriates $24 million to a nonreverting fund to be used for site infrastructure for major industrial projects, effective when the act becomes law.
- Makes various changes to the Job Development Investment Grant (JDIG) program, effective when the act becomes law.
- Extends the Bill Lee Act sunset and other deadlines for major pharmaceutical manufacturing and bioprocessing facilities, effective beginning in 2004.
- Authorizes annual sales tax refunds for construction materials for major pharmaceutical manufacturing and bioprocessing facilities, effective January 1, 2004.
- Extends the sunset on the cigarette exportation tax credit from 2005 to 2018 with the additional requirement that the taxpayer use the North Carolina State Ports. This part also allows the credit to be claimed by successors in business and modifies the base year determination.
- Allows a corporate income tax credit for tobacco manufacturers who export cigarettes to foreign countries, who use the North Carolina State Ports, and who maintain employment levels in this State that exceed the corporation's employment level in this State at the end of 2004.
- Establishes an Authority to study and make recommendations for creating a credit enhancement program for financing construction of infrastructure for life sciences manufacturing facilities.

FISCAL IMPACT:

ANALYSIS:

Major Industrial Site Infrastructure

Part 1 of the act creates a nonreverting Site Infrastructure Development Fund in the Department of Commerce to fund site acquisition and development and other capital expenses related to major industrial development. The act would appropriate $24 million to the new Fund for the 2003-2004 fiscal year. A Site Infrastructure Development incentive may be in the form of a restricted grant or forgivable loan directly to a business or a grant to a government or nonprofit agency to administer the incentive.

Projects built with this appropriation are exempted from State construction requirements and State purchase and contract requirements, with one exception. When public funds are expended, the State's policy of minority participation and State's minority participation goal of 10% applies. Projects are also exempted from the part of the State Environmental Policy Act that requires detailed environmental impact statements when public funds or public lands are used for projects and programs significantly affecting the quality of the environment.

Eligible businesses may apply for site development incentives. To qualify for a site development incentive, a business must employ at least 100 new fulltime employees and invest at least a $100 million of private funds in the project. A business must also provide health insurance for its full-time employees and have a history of compliance with the Occupational Safety and

Health Act and programs implemented by the Department of Environment and Natural Resources.

The Department of Commerce and the Economic Investment Committee[61] will administer the selection process, including developing appropriate criteria for evaluating applicants. Section 1.3 of the act exempts them from rulemaking procedures in administering this program. Site development incentives can be awarded only if necessary to secure the project in this State. The before approving an application, the Committee must find that the price to be paid for the site is appropriate and not excessive. Section 1.4 of the act provides that the JDIG conflict of interest restrictions will apply to the site infrastructure development program as well.

Once an incentive is awarded, the Department will enter into an agreement with the business to provide site development within available funds. The agreement must include a provision prohibiting a business from receiving a payment or other benefit under the agreement when the business has received notice of an overdue tax debt and the overdue tax debt has not been satisfied or otherwise resolved. The agreement is binding on both parties. The agreement must include performance criteria, remedies, and other safeguards to protect the State's investment. The Attorney General must review and approve each agreement.

After a site development incentive is in effect, the Department of Commerce is responsible for monitoring the business's compliance with performance criteria and for carrying out the clawback process if there is a default. The Department of Commerce is required to report quarterly to Governmental Operations on the details of the program, including projects that receive incentives and any defaults and repayments. This report must also be made available to the public.

Job Development Investment Grant Changes

Part 2 of the act makes several changes to the JDIG program. These changes would be effective when the act becomes law.

Section 2.2 provides that, in determining whether a business has increased or maintained employment, the Committee can decide to look at a division or unit of a business rather than the entire business. Choosing this option means that if the entire business decreases employment, it may still qualify for a grant for a division or unit within the business that increases employment. The Committee can choose this option only if it is necessary to secure the project and the contract contains terms to assure that the business does not create eligibility by transferring existing jobs to the project.

Section 2.3 of the act repeals the wage standard as it applies to the JDIG program. This proposal arises due to several concerns. First, at the time a business applies for a JDIG grant, the wages to be paid are just projections. Second, the law has been interpreted to require the jobs to meet not only the current wage standard, but also future wage standards, which can fluctuate annually. This creates a great deal of uncertainty as to the prospect of actually receiving a grant in future years of the contract. Third, while there is no wage standard for tiers one and two and the wage standard is set below the county average for prosperous tier five counties, the mid-range counties must meet the actual county average. With sudden and severe

[61] The Economic Investment Committee, which administers the JDIG program, is a five-member committee consisting of the Secretary of Commerce, the Secretary of Revenue, the Director of the Office of State Budget and Management, one member appointed by the General Assembly upon the recommendation of the Speaker of the House of Representatives, and one member appointed by the General Assembly upon the recommendation of the President Pro Tempore of the Senate

dislocation, the wage standard may block incentives for a project that would be vital to economic recovery for a county suffering from dislocation of manufacturing industries. Finally, because grants are awarded at the discretion of the Committee, the Committee can use its judgment to assure that grants are not awarded to inappropriate, low-wage projects.

Sections 2.1, 2.4, and 2.5 are more technical. Section 2.1 clarifies that the base period for measuring performance under a grant agreement can be any 24 months starting when performance begins – it is not limited to calendar years. Section 2.1 also adds the definition of enterprise tier to the statute. Section 2.4 clarifies the procedure for publication and public comment on proposed changes to the JDIG criteria. Section 2.5 clarifies that payments under a grant can begin on a future date after it is awarded, as long as they begin within six years.

Extend Bill Lee Credits for Certain Major Industries

In 2002, the General Assembly extended the sunset date on the Bill Lee Act until January 1, 2010, for certain interstate air couriers and also increased various time frames in the Bill Lee Act from two years to seven years. The rationale for these extensions was that the interstate air courier industry, and the construction of a hub in particular, face many regulatory, administrative, and legal hurdles not generally faced by other industries. Due to these extra burdens, there is generally a longer period between the time that a project is announced and a location is selected and the time the facility is placed in service.

Effective beginning with the 2004 tax year, Part 3 of the act makes the same extensions for eligible major industries. An eligible major industry is either of the following two industries if the taxpayer will invest at least $100 million in acquiring, constructing, or equipping a facility to engage in the industry:

- Bioprocessing
- Pharmaceutical and Medicine Manufacturing and the Distribution of Pharmaceuticals and Medicines

If the taxpayer does not in fact invest the required amount, it forfeits the benefits of the extensions and must repay the credits.

Major Industrial Facility Sales Tax Refunds

Part 4 of the act creates an annual refund of State and local sales taxes paid on construction materials and fixtures for facilities that involve the investment of more than $100 million by the taxpayer and are primarily used for either of the following two industries:

- Bioprocessing
- Pharmaceutical and Medicine Manufacturing and the Distribution of Pharmaceuticals and Medicines

The taxpayer must apply for the sales tax refund within six months after the end of the State's fiscal year. The refund would become effective for sales taxes paid on or after January 1, 2004. If, after obtaining a refund, the taxpayer does not end up investing the required amount, the taxpayer forfeits the refund.

Cigarette Exportation Tax Credit

Part 5 of the act extends for thirteen years the sunset of the corporate income tax credit for manufacturing cigarettes for exportation, G.S. 105-130.45, which was enacted in 1999. The credit is a dollar amount per cigarette exported for those manufacturers who export at least 50% as many cigarettes in the taxable year as they did in calendar year 1998. The dollar

amount ranges from forty cents to twenty cents per 1,000 cigarettes exported. The credit is capped at the lesser of $6 million per year or 50% of the manufacturer's corporate tax liability for any given year. The credit is set to sunset for cigarettes exported on or after January 1, 2005. Part 5 of the act would change the sunset to 2018.

Part 5 also makes four other substantive changes to the credit for manufacturing cigarettes for exportation:

- It changes the base year for determining the exportation volume from 1998 to 2003, effective for cigarettes exported on or after January 1, 2005.
- It provides that the taxpayer must export cigarettes through the North Carolina State Ports, effective for cigarettes exported on or after January 1, 2005.
- It allows a successor in business to a corporation that claimed the credit to continue to claim the credit. In this case, the amount of credit allowed is determined by comparing the exportation volume of the corporation in the year for which the credit is claimed with all of the corporation's predecessor corporations' combined base year exportation volume. This provision becomes effective for cigarettes exported on or after January 1, 2005.
- It expands the credit by allowing the credit to be claimed for the exportation of cigarettes to a possession of the United States or a commonwealth of the United States that is not a state. This provision becomes effective for taxable years beginning on or after January 1, 2004.

Prior to enactment of the cigarette exportation tax credit during the 1999 Session, the issue was raised as to whether or not that tax credit would violate GATT, one of the international trade agreements. The General Assembly staff was of the opinion that the tax credit would violate GATT, while counsel for one of the four tobacco manufacturers disagreed. This issue has not been resolved, and the proposed credit in this act presents the same issue. It is clear, however, that any challenge to either the current credit or the credit created in Part 6 of this act must come from a foreign government. If a foreign government were to challenge the credit, then the U.S. Justice Department could sue North Carolina. If the Department were to win, the federal statute provides that relief would be prospective only and persons who had already used the credit could not be required to repay it. Private citizens have no cause of action on the issue.

Enhanced Cigarette Exportation Tax Credit

Part 6 of the act allows a corporate income tax credit for tobacco manufacturers who export cigarettes to foreign countries, who use the North Carolina State Ports, and who maintain employment levels in this State that exceed the corporation's employment level in this State at the end of 2004 by at least 800 full-time employees. The credit would become effective with the 2006 tax year and would expire for exports made on or after January 1, 2018.

The credit is a dollar amount per cigarette exported for those manufacturers who meet the eligibility requirements. The credit amount is equal to forty cents per 1,000 cigarettes exported. The credit is capped at the lesser of $10 million per year or 50% of the manufacturer's tax liability for any given year. The credit may be taken against the corporate income tax or the franchise tax, or a combination of the two, at the election of the taxpayer. Once made, an election is binding and applies to all carryforwards of the credit. The taxpayer may however make a different election each year for credits earned during that year. Unused portions of a

credit may be carried forward for 10 years. Part 6 would also allow a partial credit for taxpayers who had previously met all eligibility requirements but who fail to maintain the required employment level. In computing the partial credit, the credit that would otherwise have been allowed would be reduced in proportion to the failure to the maintain the required employment level

The credit created in Part 6 differs from the credit allowed under G.S. 105-130.45 in several key ways. This credit has a higher cap ($10 million as opposed to $6 million), a longer carryforward period (10 years as opposed to five years), and may be taken against the income tax and/or the franchise tax (as opposed to only the income tax). In addition, the credit requires job creation whereas the credit allowed under G.S. 105-130.45 does not. The credit allowed under G.S. 105-130.45 applies to cigarettes exported to foreign counties, to possessions, or to U.S. commonwealths that are not states (as opposed to just to foreign countries) and requires the taxpayer to "waterborne export" through the N.C. Ports (as opposed to "export"). A taxpayer may take either this credit or the one in G.S. 105-130.45; a taxpayer may not claim both credits for the same activity.

Life Sciences Revenue Bond Authority

Part 7 of the act creates a Life Sciences Revenue Bond Authority in the Department of State Treasurer, effective when the act becomes law. It is step one of a two-step process. First, the Authority will study the best method for establishing a credit enhancement program for construction of infrastructure for life sciences manufacturing facilities. After the Authority reports its findings and recommendations to the General Assembly by May 1, 2004, the act anticipates that in the second stage the Authority would administer any program enacted by the General Assembly.

This Part of the act does not require an appropriation. The Authority is expected to perform its duties during the first phase using funds raised from private sources. In addition, the Authority is authorized to charge fees for one part of the study, in which it will accept test applications (pro forma applications) to evaluate the need for the proposed credit enhancement program. The act directs the authority to cooperate with appropriate government agencies, the UNC system, the Biotechnology Center, and others in developing its recommendations.

One example of a credit enhancement vehicle would be revenue bonds. Under existing law, the State and local governments can issue tax-exempt industrial revenue bonds for manufacturing and pollution control facilities. The bonds are retired with payments from the private business that will use the facility. The private business benefits from paying tax-exempt rates, rather than the taxable rates it would pay if it borrowed the money itself. Under Part 7, the Authority will consider using industrial revenue bonds and other approaches to credit enhancement in order to encourage the expansion of the life sciences manufacturing industry in this State.

The findings portion of Part 7 identifies the life sciences as including biology, zoology, agronomy, biochemistry, genetics, and molecular biology. The commercialization of life sciences products to diagnose and treat diseases and provide other benefits is identified as having significant economic benefit to the State. The stated intent is to encourage the development of the bioprocess manufacturing industries in order to achieve a position of national leadership and innovation in this field.

2002

Remove Scrap Tire Tax Sunset

Session Law	*Bill #*	*Sponsor*
S.L. 2002-10	**HB 1578**	**Representative Gibson**

AN ACT TO REMOVE THE SUNSET ON THE SCRAP TIRE DISPOSAL TAX.

OVERVIEW: This act removes the sunset on a 1993 provision that increased the scrap tire disposal tax from 1% to 2% for tires for car, vans, and pick-up trucks, as recommended by the Environmental Review Commission.

FISCAL IMPACT: Because none of the tax proceeds go to the General Fund, this act has no impact on the General Fund. Removing the sunset is expected to generate about $5.35 million annually that would have otherwise been eliminated by the sunset on the higher tax rate. The tax proceeds are distributed among the Scrap Tire Disposal Account, the Solid Waste Management Trust Account, and counties.

EFFECTIVE DATE: June 27, 2002.

ANALYSIS: The scrap tire disposal tax was enacted in 1989. It applies to tires sold at retail and to tires sold for placement on vehicles to be sold or leased at retail. In 1993, the tax rate on tires with a bead diameter of less than 20 inches was increased from 1% to 2%. Bead diameter is the width of the inside opening of the tire. Tires for cars, vans, and pick-up trucks have a bead diameter of less than 20 inches.

The increase in the tax rate for these smaller tires was set to sunset on June 30, 2002, which would have reduced the rate back to 1%. This act deleted the sunset so the tax rate will remain at 2% on tires with a bead width of less than 20 inches.

The net proceeds of the scrap tire disposal tax are distributed as follows: 27% to the Scrap Tire Disposal Account[1], 5% to the Solid Waste Management Trust Fund, and 68% to the counties on a per capita basis. Counties may use the proceeds of the scrap tire disposal tax distributed to them only for the disposal of scrap tires or for the abatement of nuisance tire collection sites. The Department of Environment and Natural Resources may use up to 50% of the revenue in the Scrap Tire Disposal Account for grants to local governments to assist in the disposal of scrap tires and may use up to 40% of the amount in the Account for grants to encourage the use of processed scrap tire materials. The remaining funds in the Account may be used for assistance to local governments in managing scrap tire programs, and to clean up nuisance scrap tire collection sites if no other funds are available for that purpose. The Department of Environment and Natural Resources must report to the Environmental Review Commission each year on the balances in the Account and the use of the money in the Account. The money in the Solid Waste Management Trust Fund is used to fund activities of the Department of Environment and Natural Resources to promote waste reduction and recycling, to fund research on the solid waste stream

[1] Section 2.2(j) of the Current Operations and Capital Improvement Appropriations Act of 2001 provided that the net proceeds of the Scrap Tire Disposal tax collected in 2001-02 would be credited to the General Fund instead of the Scrap Tire Disposal Account.

in North Carolina, to fund activities related to the development of secondary materials markets, to fund demonstration projects, and to fund research by in-State colleges and universities.

Conform Mobile Telecommunications Sourcing

Session Law	*Bill #*	*Sponsor*
S.L. 2002-16	**HB 1521**	**Representative Allen**

AN ACT TO CONFORM SOURCING OF MOBILE TELECOMMUNICATIONS SERVICES TO THE FEDERAL MOBILE TELECOMMUNICATIONS SOURCING ACT AND TO CODIFY THE SOURCING PRINCIPLES FOR OTHER TELECOMMUNICATIONS SERVICES.

OVERVIEW: This act conforms State sales tax law to the federal Mobile Telecommunications Sourcing Act and codifies the sourcing rules for other types of telecommunications, as recommended by the Revenue Laws Study Committee.

FISCAL IMPACT: While this legislation may redistribute tax revenue between jurisdictions because of changes in sourcing, the total amount available to local governments will not change.

EFFECTIVE DATE: Most of the act became effective for taxable services reflected on bills dated on or after August 1, 2002. This effective date corresponds with the effective date of the federal Mobile Telecommunications Sourcing Act. Two provisions are delayed until January 1, 2004: a new sourcing principle for private lines and a requirement that postpaid calling service be sourced based on the origination point of the signal.

ANALYSIS:

Prior Law: In 2001, the General Assembly simplified the taxation of telecommunications services by providing one tax at one rate for all telecommunication services, including interstate telecommunications service. Under the law, mobile telecommunications service is considered to be taxable in this State if the customer's service address is in this State and the call originates or terminates in this State. However, under the federal Mobile Telecommunications Act, mobile telecommunications service is taxable by the state of the customer's place of primary use, regardless of whether or not the call originates or terminates in the state. A mobile customer's service address and place of primary use are the same: the residential street address or the primary business street address of the customer that is within the licensed service area of the service provider. Therefore, it is the requirement that the call originate or terminate in the State that must be changed to conform to the federal mobile telecommunications sourcing rules.

***Background*:** "Sourcing" is the determination of the jurisdiction within which a transaction is considered to take place for tax purposes. Jurisdictions that tax interstate and international telecommunications generally follow the "*Goldberg* Rule", which is based on an Illinois tax that was upheld by the U.S. Supreme court in *Goldberg v. Sweet*, 488 U.S. 252 (1989). Under the *Goldberg* Rule a jurisdiction may tax a telephone call if the call meets one of the following two criteria:

- It both originates and terminates in that jurisdiction.
- It originates *or* terminates in that jurisdiction *and* is charged to a service address in that jurisdiction.

Because of the complexity of identifying the source of mobile telecommunications, federal legislation was enacted effective August 1, 2002, that sources mobile telecommunications transactions at the place of primary use, which is the same as the service address – the residential address or business premises of the purchaser.

Under the federal legislation, states may furnish service providers with a database[2] matching street addresses with taxing jurisdictions.[3] Service providers would be held harmless for any errors resulting from their use of the database. If a database is not provided for a state, then the service provider may determine the appropriate taxing jurisdiction by using an enhanced zip code[4] to assign each street address to a specific taxing jurisdiction in that state. Service providers would be held harmless from any tax liability that otherwise would be incurred solely as a result of an assignment of a street address to an incorrect taxing jurisdiction under this method. The accuracy of the method used is important to protect the tax base of local taxing jurisdictions. The hold harmless provision is important to service providers who provide service in a state with multiple taxing jurisdictions.

The Streamlined Sales Tax Project is working with the telecommunications industry on uniform provisions for sourcing as well as refund limitation provisions based upon the hold harmless provisions in the federal Mobile Telecommunications Sourcing Act. The Streamlined Sales Tax Project and the implementing states[5] have adopted principles for sourcing. The principles do not differ from North Carolina's current sourcing principles. This act codifies those principles. The Streamlined Sales Tax Project has not yet completed its work on the refund limitation provisions. Since North Carolina does not have multiple taxing jurisdictions[6], it does not currently need these provisions. Therefore, this act does not include any provisions on this issue.

SECTION-BY-SECTION ANALYSIS: This act conforms North Carolina's sourcing of mobile telecommunications to the federal Mobile Telecommunications Sourcing Act and codifies the sourcing principles adopted by the Streamlined Sales Tax Project and the 27 implementing states, as follows:

Sections 1, 3, and 15:	Replace the term "service address" and "billing address" with the term "place of primary use" because that is the terminology used in the federal Mobile Telecommunications Sourcing Act.
Sections 2, 8, 12, and 13:	Change the term "prepaid telephone calling arrangement" to the term "prepaid telephone calling service" so that the terminology is consistent with the other forms of telecommunication services.

[2] The Multi-State Tax Commission and the Federation of Tax Administrators are currently involved in a project to specify the format of the database.

[3] Some states allow local governments to impose a tax on telecommunications services, resulting in multiple taxing jurisdictions within a state.

[4] The level of accuracy for the nine-digit zip code ranges from 85% to 99%. A more accurate system may be developed using a geographic mapping system. The federal law gives each state the ability to develop a more accurate system if it so chooses.

[5] There are 27 states that have enacted legislation based on either the Uniform Sales and Use Tax Administration Act or the Simplified Sales and Use Tax Administration Act: AR, FL, IL, IN, KY, LA, ME, MD, MI, MN, NE, NV, NJ, NC, ND, OH, OK, RI, SD, TN, TX, UT, WA, WI, WV, WY, and the District of Columbia.

[6] North Carolina distributes a portion of the State-imposed telecommunications tax to the cities.

Sections 4 and 5: Prepaid telephone calling services are taxed as tangible personal property, not as a telecommunications service. Section 4 removes the sourcing language from the statute that sets the sales tax rates and Section 5 modifies the sourcing principles that apply to tangible personal property to accommodate the taxation of prepaid telephone calling services.

Section 6: Deletes the sentence that sources mobile telecommunications based on the call originating or terminating in this State because it conflicts with the sourcing principle in the federal Mobile Telecommunications Sourcing Act. It also specifies that mobile telecommunications services are taxed in accordance with federal law. This reference alerts the reader that there is applicable federal law on this issue.

Sections 7 and 11: Under the federal Mobile Telecommunications Sourcing Act and the Streamlined Sales Tax Project, telecommunications service is sourced based on the type of service provided rather than the type of call. These sections define the different types of services and repeal the terms associated with the types of calls.

Sections 9 and 10: Set forth the mobile telecommunications sourcing principle in the federal Mobile Telecommunications Sourcing Act, and codify the principles currently used by the State to source other telecommunications services. Section 10 rewrites the sourcing principles for private telecommunications service in a more understandable format and adds a sourcing principle that is not currently applicable to private lines in the State, but may be applicable in the future. The principles codified are the same principles adopted by the Streamlined Sales Tax Project and the implementing states in March of 2002. Under the act, at the request of the telecommunications industry, the new sourcing principle applicable to private telecommunications service does not become effective until January 1, 2004.

Sections 9 and 14: Under the Streamlined Sales Tax Project, postpaid calling service will be sourced based on the origination point of the telecommunications signal as first identified by the seller's telecommunications system. However, not every company in the telecommunications industry has the capability to determine the origination point of the signal. The act gives the seller two options to source postpaid calling service until 2004; beginning in 2004, the seller must source based on the origination point of the telecommunications signal.

Certain Counties Delinquent Taxes

Session Law	*Bill #*	*Sponsor*
S.L. 2002-51	**HB 1533**	**Representative Hunter**

AN ACT TO AUTHORIZE CERTAIN COUNTIES TO REQUIRE THE PAYMENT OF DELINQUENT PROPERTY TAXES BEFORE RECORDING DEEDS CONVEYING PROPERTY AND TO MODIFY

THE TIMETABLE FOR STOKES COUNTY OR ANY OF ITS MUNICIPALITIES TO ADOPT A SCHEDULE OF DISCOUNTS FOR PREPAYMENT OF PROPERTY TAXES.

OVERVIEW: S.L. 2002-51 authorizes the county commissioners in Bertie, Clay, Durham, Henderson, Hertford, Macon, Northampton, Polk, Rutherford, and Transylvania Counties to require the register of deeds to refuse to register a deed unless the county tax collector has certified that no delinquent taxes are due on the property. In addition, this act allows the governing body of Stokes County or any of its municipalities to provide a schedule of discounts for property taxes paid prior to November 1, 2002.

FISCAL IMPACT: This act has no impact on the General Fund.

EFFECTIVE DATE: This act became effective when it became law, July 30, 2002.

ANALYSIS: Since 1963, the General Assembly has prohibited the register of deeds in several counties and municipalities from recording deeds unless the tax collector certifies that no delinquent taxes are due: Avery County (1963); Mitchell County (1987); Ashe County (1993); the Towns of Newland and Spruce Pine and Alleghany County (1997); the Town of Banner Elk (1998); and the Town of Bakersville (1999).

In 2001, the General Assembly gave the county commissioners in 35 counties the authority to adopt a resolution requiring the county tax collector to certify that no delinquent taxes the collector is charged to collect are due on the property before a deed transferring the property can be recorded. S.L. 2001-464 gave this authority to the following 25 counties: Alleghany, Anson, Beaufort, Cabarrus, Camden, Cherokee, Chowan, Currituck, Forsyth, Graham, Granville, Harnett, Haywood, Jackson, Lee, Madison, Montgomery, Pasquotank, Perquimans, Pitt, Stanley, Swain, Vance, Warren, and Yadkin Counties. S.L. 2001-513 gave this authority to the following 10 counties: Carteret, Cleveland, Davidson, Gaston, Iredell, Martin, Person, Rockingham, Rowan, and Washington Counties. Unlike the previous local acts, the authority given by these two 2001 acts is permissive. To use this collection tool, the board of county commissioners must adopt a resolution on the matter. The resolution may describe the form the certification must take.

S.L. 2002-51 extends to the following 10 counties the permissive authority given to the 35 counties in 2001: Bertie, Clay, Durham, Henderson, Hertford, Macon, Northampton, Polk, Rutherford, and Transylvania Counties.

In addition, S.L. 2002-51 allows Stokes County and it municipalities to institute, without the approval of the Department of Revenue, a schedule of discounts to be applied to property taxes paid prior to November 1, 2002. The governing body that adopts the resolution must submit a certified copy to the Department of Revenue and must publish the discount schedule at least once in a newspaper of general circulation in the taxing unit. In general, under G.S. 105-360(c), a county or municipality that levies a property tax may adopt a resolution or ordinance to establish a schedule of discounts for taxes paid prior to the due date. In order to exercise this authority, the county or municipality must 1) adopt the resolution or ordinance specifying the schedule of discounts prior to May 1, 2) submit the resolution or ordinance to the Department of Revenue for approval, and 3) upon approval of the resolution or ordinance, publish the discount schedule at least once in a newspaper of general circulation in the taxing unit.

Revenue Laws Technical Changes

Session Law	*Bill #*	*Sponsor*

S.L. 2002-72	SB 1160	Senator Hartsell

AN ACT TO MAKE TECHNICAL AND CLARIFYING CHANGES TO THE REVENUE LAWS AND RELATED STATUTES AND TO PROVIDE A ONE-TIME EXTENSION TO THE TIME PERIOD IN WHICH A TAXPAYER MAY SIGN A LETTER OF COMMITMENT WITH THE DEPARTMENT OF COMMERCE TO QUALIFY FOR A LOWER TIER DESIGNATION.

OVERVIEW: Senate Bill 1160 makes numerous technical and clarifying changes to the revenue laws and related statutes. It also makes one substantive change. The original bill was a recommendation of the Revenue Laws Study Committee.

FISCAL IMPACT: Section 1 of this act, which allows a one-time exception to the requirement that a letter of commitment be signed before year's end, has an annual cost to the General Fund of $725,000 through the 2006-2007 fiscal year and an annual cost of $25,000 for three years thereafter. The remainder of this act has no fiscal impact.

EFFECTIVE DATE: Except for Section 9 of the bill, which conforms the payment date for the insurance regulatory charge on HMOs to the date they file their premium tax returns and which becomes effective for taxable years beginning on or after January 1, 2003, this act became effective when it became law on August 12, 2002.

ANALYSIS:

SUBSTANTIVE CHANGE: Section 1 of the bill was introduced by Senator Soles as Senate Bill 1344. It allows a taxpayer that signed a letter of commitment with the Department of Commerce on or before February 28, 2002, to calculate its Bill Lee jobs creation tax credit and machinery and equipment investment tax credit based on the location's enterprise tier and development zone designation for 2001 rather than 2002. This change would benefit taxpayers creating jobs or making eligible investments in areas whose tier designations increased for the calendar year 2002.

Under the Bill Lee Act, all counties are divided into five enterprise tiers, ranked by economic distress as measured by a formula that combines unemployment, per capita income, and population growth. The Department of Commerce must designate the counties' tier designations for the following year on or before December 31 of each year, based on the most recent data available. The Department of Commerce did not make the counties' tier designations for the 2002 calendar year until April 2002. It appears some taxpayers signed letters of commitment by February 28, 2002, under the belief they would be able to calculate the credit for which they qualified based on the location's enterprise tier designation for 2001. However, this was not possible under then existing law for locations whose tier designation changed for 2002.

Section 1 of this bill allows a taxpayer that signed a letter of commitment with the Department of Commerce during January or February 2002 for future planned expansion to calculate its Bill Lee jobs creation tax credit and investment tax credit based on the location's enterprise tier designation for 2001 rather than 2002. Because this section is permissive, its effect is to benefit taxpayers creating jobs or making eligible investments in areas whose designations increased for the calendar year 2002. The Department of Commerce reports that it has eight letters of commitment signed on or before February 28, 2002, in counties whose tier designations increased from 2001 to 2002.[7] The following chart shows the counties that will be affected by

[7] Although the bill also applies to areas designated as a development zone, it has no practical application for development zones because there were no letters of commitment signed with the Department of Commerce for a project in a development zone on or before February 28, 2002.

this section and the difference the section will make in the credit amounts the taxpayers qualify for:

COUNTY[8]	LOC's SIGNED BY 02/28/02	2001 TIER DESIGNATION *The credit and threshold amounts the taxpayer will receive under this section.*	2002 TIER DESIGNATION *The credit and threshold amounts the taxpayer would have received if this act had not been enacted.*
Columbus	3	Tier 1: Jobs tax credit = $12,500 Threshold amount = $0	Tier 2: Jobs tax credit = $4,000 Threshold amount = $100,000
Richmond	1	Tier 1: Jobs tax credit = $12,500 Threshold amount = $0	Tier 2: Jobs tax credit = $4,000 Threshold amount = $100,000
Montgomery	1	Tier 2: Jobs tax credit = $4,000 Threshold amount = $100,000	Tier 3: Jobs tax credit = $3,000 Threshold amount = $200,000
Cumberland	1	Tier 3: Jobs tax credit = $3,000 Threshold amount = $200,000	Tier 4: Jobs tax credit = $1,000 Threshold amount = $500,000
Franklin	2	Tier 4: Jobs tax credit = $1,000 Threshold amount = $500,000	Tier 5: Jobs tax credit = $500 Threshold amount = $1,000,000

TECHNICAL CHANGES: The Revenue Laws Study Committee recommended The Revenue Laws Technical Changes bill. The following table provides a section-by-section analysis of the technical changes.

SEC.	G.S./S.L.	EXPLANATION
2	S.L. 1967-1096, as amended by S.L. 2001-414	Corrects a grammatical error.
3	S.L. 2001-264	Clarifies S.L. 2001-264, An Act To Provide Uniform Penalties For Local Meals Taxes. That act made all local meals tax penalties uniform by applying the existing State sales and use tax penalties to meals taxes. The act was intended to improve tax administration by making uniform the tax penalties for each local

[8] Onslow County moved from a Tier 2 county designation in 2001 to a Tier 3 county designation in 2002. However, it is not affected by this act because there were no letters of commitment signed with the Department of Commerce for a project located in that county on or before February 28, 2002.

SEC.	G.S./S.L.	EXPLANATION
		meals tax. After the act became law, staff noticed that its language might not be sufficiently clear to assure that the penalties will be uniform in each jurisdiction. This section adds language to clarify that additional or higher local penalties are repealed.
4	S.L. 2001-414	Corrects an incorrect cross-reference.
5	S.L. 2001-472	Corrects a typographical error. Although Section 3(a) of S.L. 2001-427 purports to amend just subsection (a) of G.S. 105-472, it actually amends the entire statute. This section conforms the law to accurately state that it amends the entire statute.
6	G.S. 20-10.1	Updates a cross-reference to a definition.
7	G.S. 20-17.4	Adds a missing phrase.
8	G.S. 20-87	Restores language intended to be enacted in 2001 but omitted due to a redlining error.
9	G.S. 58-6-25	Conforms the payment date of the insurance regulatory charge on HMOs to the date they file their premiums tax return. This has no substantive effect because the dates are the same in current law.
10	105-116	Deletes an obsolete cross-reference to a tax credit that is no longer allowed against franchise tax.
11	G.S. 105-127	Repeals two obsolete subsections. These subsections exempt certain stock from property tax. All stock is now exempt from property tax under G.S. 105-275(31).
12	G.S. 105-129.4	Corrects an incorrect word.
13	G.S. 105-129.12A	Conforms terminology to a change in procedure that was enacted in 2001.
14	G.S. 105-130.5	Clarifies that the corporate income tax deduction for 911 charges applies only if the taxpayer included the charges in federal taxable income. Without this correction, there could be an unintended double deduction for these charges.
15	G.S. 105-130.34 G.S. 105-151.12	Clarifies that the credit for conservation donations applies only if the interest in real property is donated in perpetuity. This conforms the statute to interpretations by DOR and DENR[9]. Comparable federal law requires that a donation be (1) the entire interest of the donor, (2) a remainder interest, or (3) a restriction in perpetuity. This provision was introduced as Sections 1 and 2 of Senate Bill 1252, recommended by the Environmental Review Commission.

[9] Under 15A NCAC 1F .0001 through .0006, DENR will certify donated property for the credit only if it provides a perpetual public benefit.

SEC.	G.S./S.L.	EXPLANATION
16	G.S. 105-163.7	Repeals an obsolete subsection. The Industrial Commission receives the same information from another source now and no longer wants to get it from the Department of Revenue
17	G.S. 105-164.23	Conforms and updates language.
18	G.S. 105-164.27A	Deletes extra language intended to be deleted in 2001 but retained due to a redlining error.
19	G.S. 105-187.1, G.S. 20-4.01, G.S. 20-116, G.S. 20-305.2	Conforms the definition of "recreational vehicle" in the highway use tax to the definition in the motor vehicles law, and eliminates inconsistent usage of the term. Also, clarifies and reorganizes the statute governing vehicle length.
20	G.S. 105-269.14	Conforms the use tax distribution percentage to reflect past and future rate changes.
21	G.S. 159I-1	Conforms the statutory short title in G.S. 159I-1 to match the title of G.S. Chapter 159I, which was amended in 2001.

Housing Tax Credit Chngs/Estate Tax Chngs

Session Law	*Bill #*	*Sponsor*
S.L. 2002-87	**SB 1416**	**Senator Kerr**

AN ACT TO IMPROVE THE LOW-INCOME HOUSING TAX CREDIT BY MAKING IT SIMPLER AND LESS COSTLY WHILE PROVIDING THE SAME LEVEL OF INCENTIVES FOR THE CONSTRUCTION OF LOW-INCOME HOUSING AND TO MODIFY THE FORMULA FOR CALCULATING NORTH CAROLINA ESTATE TAX ON ESTATES WITH PROPERTY IN MORE THAN ONE STATE.

OVERVIEW: This act modifies the low-income housing tax credit to make it simpler and more efficient and modifies the formula for calculating estate tax on estates with property in more than one state.

FISCAL IMPACT:

The projected revenue impact of the housing tax credit changes are as follows:

FY 2004-05	- $8 million
FY 2005-06	- $9.8 million
FY 2006-07	$2.9 million
FY 2007-08	$24.5 million

The other sections of the act are assumed to have little or no impact on the General Fund.

EFFECTIVE DATE: The low-income housing tax credit changes became effective beginning with the 2002 tax year for the existing credit and in 2003 for buildings that are awarded a federal credit allocation on or after January 1, 2003. The estate tax change became effective for the estates of decedents dying on or after January 1, 2002.

ANALYSIS:

LOW-INCOME HOUSING TAX CREDIT: Congress enacted the Low Income Housing Tax Credit in 1986 to fund housing for low- and moderate-income households. Each state receives a limited amount of credit each year. The IRS allocates the per capita low-income housing tax credit to state housing agencies, such as the North Carolina Housing Financing Agency, who in turn allocate the credit to project developers who agree to lower project rents for low-income tenants. In 1999, North Carolina authorized a State income tax credit equal to a percentage of the developer's federal tax credit for low income housing constructed in North Carolina. A project developer sells the tax credits to receive funds to finance the project. Developers indicate that the State tax credit sells for no more than 45 cents on the dollar.

During the 2002 session, the General Assembly became aware of several concerns with the low-income housing tax credit:

- The sale of a dollar tax credit for less than 45 cents is an inefficient use of State tax expenditures.
- The process of selling the tax credits is complex. It involves finding investors, negotiating prices, and completing legal documents.
- The pool of investors interested in purchasing the credit is limited and is diminishing.

This act addresses these concerns in two ways:

- To address the short-term problem of utilizing the tax credits allocated to developers, the act reduces the tax basis required of a purchaser from 100% to 40%.
- To address the long-term problem of the complexity and inefficiency of the credit, the act converts the State credit, which is sold to investors, to a refundable credit, received directly by the owner and invested directly in the project.

New, Refundable Credit for Housing with Federal Allocations beginning 1/1/03: A taxpayer who is allocated a federal low-income housing tax credit is allowed a credit equal to a percentage of the development's eligible basis. Unlike the existing credit that must be taken over five years, the new refundable credit is taken in one year. The existing State credit is a percentage of the federal credit and the percentage varies depending on the tier designation of the county. The new refundable credit is a percentage of the basis for which a federal credit is allowed and the percentage varies depending on the type of development. The eligibility of a development is based upon two factors:

- Income designation of the county or city in which it is located. – The designation of a county or city as "low income", "moderate income", or "high income" is made by the North Carolina Housing Finance Agency ("HFA") in accordance with the Qualified Allocation Plan in effect as of the time the federal credit is allocated. The Qualified Allocation Plan is adopted annually. The Governor must approve it after a public hearing and publication in the North Carolina Register. A change in the income designation does not affect the developer's eligible basis for which a credit is allowed.
- Affordability requirements. – The affordability requirements are set in the statute and apply for the duration of the federal tax credit compliance period. If in any year a taxpayer fails to meet these affordability requirements, the credit is forfeited.

The chart below sets out the percentage of the developer's eligible basis for which a credit is allowed:

Type of Development	Percentage of Basis for which Credit is Allowed
• Units are in a "low income" county or city • 40% of the qualified residential units are affordable to households whose income is 50% or less of area median income	30%
• Units are in a Moderate Income county or city • 50% of the qualified residential units are affordable to households whose income is 50% or less of the area median income	20%
• Units are in a High Income county or city • 50% of the qualified residential units are affordable to households whose income is 40% or less of the area median income	10%
• Units are in a High Income county or city • 25% of the qualified residential units are affordable to households whose income is 30% or less of the area median income	10%

Credit Election: A taxpayer entitled to the new, refundable low-income housing tax credit may elect to receive the credit in the form of either a direct tax refund or a loan generated by transferring the credit to the HFA. Neither a direct tax refund nor a loan received as a result of the transfer of the credit is considered taxable income by the State. The IRS would consider a direct tax refund taxable. A letter ruling will be submitted to the IRS to clarify whether the loan proceeds would be taxable. The initial indication is that the proceeds would not be taxable.

If a taxpayer chooses the loan method for receiving the credit, the Secretary must transfer to the HFA the amount of credit allowed the taxpayer. The HFA must loan the amount of the credit to the taxpayer on terms consistent with the Qualified Allocation Plan. The HFA is not required to make the loan until the Secretary transfers the credit amount to it.

If a taxpayer chooses the direct tax refund method for receiving the credit, the Secretary must transfer to the HFA the refundable excess of the credit allowed the taxpayer. The HFA holds the refund in escrow, with no interest accruing to the taxpayer during the escrow period. The HFA must release the refund to the taxpayer upon the occurrence of the earlier of the following:

- The HFA determines that the taxpayer has complied with the Qualified Allocation Plan and has completed at least 50% of the activities included in the development's eligible basis.
- The expiration of 30 days after the development's placed in service date.

Forfeiture: If a taxpayer fails to meet the State's affordability requirements for the duration of the federal tax credit compliance period, the State credit is forfeited. If the taxpayer is required to recapture all or part of the federal credit with respect to a qualified North Carolina

low-income development, the State credit is also forfeited. A taxpayer that forfeits all or part of the State credit is liable for all past taxes avoided and any refund claimed as a result of the credit plus interest. This amount is payable 30 days after the date the credit is forfeited. The interest is computed from the date the Secretary transferred the credit amount to the HFA.

A taxpayer that is required to recapture all or part of the federal credit with respect to a qualified North Carolina low-income development does not forfeit the corresponding State credit amount in the following circumstances:

- The recapture is the result of an event that occurs in the sixth or subsequent calendar year after the calendar year in which the development was awarded a federal credit allocation.
- The taxpayer elected to transfer the State credit amount to the HFA and received a loan from the HFA for that amount.

Report: The Department of Revenue must report to the Revenue Laws Study Committee and the Fiscal Research Division of the General Assembly by May 1 of each year the following information for the 12-month period ending the preceding April 1:

- The number of taxpayers that claimed the low-income housing credit.
- The location of each qualified North Carolina low-income building or housing development for which a credit was claimed.
- The total cost to the General Fund of the credits claimed.

Sunset: Like the existing low-income housing tax credit, this new refundable credit is repealed effective January 1, 2006.

Modifications for Existing Credit for Housing with Federal Allocations before 1/1/03: Often the investment group financing a low-income housing project is a pass-through entity. In 2001, the General Assembly provided that the low-income housing credit could be allocated among any of the entity's owners, in the entity's discretion, as long as the amount of credit allocated did not exceed the owner's adjusted basis in the pass-through entity. This tax basis requirement means the investor must invest $1 into the project for each $1 of the State credit received. However, the General Assembly determined in 2002 that the market rate for the credit was about 45 cents for each $1 of State credit. The pool of investors willing and able to meet the tax basis requirement was smaller than the need for investment. Without a change in the tax basis requirement, many developers with projects underway may have lost money on those projects. To encourage more investment immediately, the act reduced the tax basis required of a purchaser from 100% to 40%.

The act also addresses the issue of forfeiture of the existing credit by providing that the taxpayer does not forfeit the State credit if a recapture of the federal credit occurs after the State five-year credit period has expired. The federal credit is taken over a 10-year period.

ESTATE TAX CHANGES: Section 9 of the act incorporates a proposal from the Estate Tax Section of the North Carolina Bar Association.[10] It changes the calculation of estate tax due when property is located in more than one state from a net value ratio to a gross value ratio. Before this act became law, North Carolina was one of only three states that prorated based

[10] Representative Haire introduced a bill on this issue in 2001, House Bill 276.

on the net value of the federal taxable estate. At least 36 states prorate based on gross values, including the neighboring states of South Carolina and Virginia.

For estates with property only in North Carolina, the North Carolina estate tax equals the credit for state death taxes allowed on the federal estate tax return.[11] If an estate has property in more than one state, the federal credit must be prorated between North Carolina and the other states in which the estate has property. Under prior law, the percentage of the federal credit allocated to North Carolina was determined by dividing the net value of the property in North Carolina by the total net value of the property in the estate.

Net value equals the gross value of the property less any debts associated with the property, such as a mortgage. The prior law was attempting to allocate the credit based on the value of the property that was includible in the taxable estate for federal purposes. The federal estate tax is calculated on the taxable estate, which is the gross estate less allowable deductions such as debts.

The Estate Tax Section of the North Carolina Bar Association asserted that a state's share of federal estate tax is more appropriately based on the gross property located in a state whether or not the property generates any federal estate tax. It proposed that this approach is fair because each state has a responsibility for protecting and supervising the distribution of property regardless of whether it generates federal tax. Also, the use of a net value calculation sometimes results in a North Carolina resident paying more tax than 100% of the amount of the credit.[12] In other instances it may result in a loss of revenue to North Carolina[13]; this may be particularly true in estates in which property qualifies for the marital deduction.

Extend Qualified Business Venture Tax Credit

Session Law	*Bill #*	*Sponsor*
S.L. 2002-99	**HB 1520**	**Representative Allen**

AN ACT TO EXTEND THE SUNSET ON TAX CREDITS FOR QUALIFIED BUSINESS INVESTMENTS, TO AMEND THE DEFINITION OF QUALIFIED GRANTEE BUSINESS, TO EXTEND THE SUNSET ON THE STATE PORTS TAX CREDIT, AND TO CLARIFY AND AMEND THE NORTH CAROLINA STATE PORTS AUTHORITY'S FEE-SETTING AUTHORITY.

OVERVIEW: This act extends the tax credit on qualified business investments and the State ports tax credit from January 1, 2003 to January 1, 2004, and revises the definition of "qualified grantee business" to alleviate a constitutional concern by replacing specific named entities with general descriptions of entities. The act also clarifies that the North Carolina State

[11] The credit for state death taxes allowed on the federal estate tax return is being phased out over the next four years. As a result of legislation enacted in 2002 (S.L. 2002-126), North Carolina does not conform to the phase-out of this credit for 2002 and 2003.

[12] A Charlotte resident has a gross estate worth $10,000,000, including a $2,000,000 home in South Carolina with a $1,000,000 mortgage. The South Carolina portion of the credit is 20% because South Carolina uses a gross value calculation: 2,000,000 divided by 10,000,000. The North Carolina portion of the credit is 88%: 8,000,000 divided by 9,000,000.

[13] A Charlotte resident has a gross estate worth $10,000,000, including a $2,000,000 home in South Carolina. The North Carolina property has a $1,000,000 mortgage. The South Carolina portion of the credit continues to be 20%. However, the North Carolina portion of the credit is reduced to 77%: 7,000,000 divided by 9,000,000.

Ports Authority has fee-setting authority for its rates and tariffs, gives the Authority guidelines to use in setting those fees, requires the Authority to report to the Joint Legislative Commission on Governmental Operations no later than 30 days after it establishes or increases a fee, and exempts the Authority's fee-setting from the rule-making portion of the Administrative Procedure Act.

FISCAL IMPACT: The amount of the tax credit on qualified business investments that is given each year is capped at $6 million. Because requests for credits have exceeded this cap for four out of the last five years, it is likely that the $6 million annual cost of the program will continue until its sunset in 2004. The General Fund impact due to the extension of this tax credit will occur in the 2003-2004 fiscal year because the investments made in 2003 will be awarded credits on returns filed in the spring of 2004. The extension of the State Ports Authority tax credit is estimated to cost the General Fund $650,000 in the 2003-2004 fiscal year. The changes to the State Ports Authority fee-setting power have no fiscal impact.

EFFECTIVE DATE: The change to the definition of "qualified grantee business" is effective January 1, 2003. The remainder of this act became effective August 29, 2002.

ANALYSIS:

QUALIFIED BUSINESS INVESTMENT TAX CREDIT: The qualified business investment tax credit was enacted in August 1987 to promote economic development for North Carolina businesses. The initial credits applied to both corporations and individual taxpayers, and there was a $12 million cap on the total amount of all tax credits. In response to a 1996 United States Supreme Court decision in Fulton Corp. v. Faulkner, the General Assembly reduced the $12 million cap to $6 million, limited the credit to individuals and small pass-through entities, and removed the requirement that the qualified businesses be headquartered or operating in North Carolina. The credit was to expire for investments made on or after January 1, 1999. In 1998, as part of the appropriations bill, the credit was extended for four additional years until January 1, 2003. This act extends the sunset for one additional year until January 1, 2004.

Explanation of the credit: The qualified business investment tax credit is allowed for an individual taxpayer who purchases the equity securities or subordinated debt of a qualified business venture or a qualified grantee business directly from that business. The credit is equal to 25% of the amount invested and may not exceed $50,000 per individual in a single taxable year. An individual investor may also claim the allocable share of credits obtained by "pass-through entities" of which the investor is an owner. Pass-through entities include limited partnerships, general partnerships, S corporations, and limited liability companies. The credit may not be taken in the year the investment is made. Instead, the credit is taken in the year following the calendar year in which the investment was made, but only if the taxpayer filed an application with the Secretary of State. The unused credit may be carried forward for the next five years. The total amount of credits allowed to all taxpayers for investments made in a calendar year may not exceed $6 million. The Secretary of Revenue calculates the total amount of tax credits claimed from applications filed with the Secretary of State. If the amount exceeds the cap, then the Secretary allows a portion of the tax credits claimed by allocating the total of $6 million in tax credits in proportion to the size of the credit claimed by each taxpayer. In general, a taxpayer forfeits the credit if the taxpayer transfers the securities within one year

or the qualified business redeems the securities purchased by the taxpayer within five years after the investment was made.[14]

Impact of Fulton Corp. v. Faulkner: Under the 1996 Fulton case, the original credit provisions clearly violated the interstate commerce clause of the federal constitution because they reduced a taxpayer's tax liability by an amount equal to 25% of the cost of purchasing stock in either a North Carolina business or an investment company whose purpose is to invest in North Carolina businesses, while no tax reduction was allowed for purchasing similar stock in out-of-state businesses or investment companies whose purpose is to invest in businesses that may not be North Carolina businesses. In response to the Fulton case, the Revenue Laws Study Committee discussed this credit, along with several others, at great length. The original proposal of the Committee was to repeal all qualified business investment credits, effective January 1, 1997. In response to appeals to the Committee and to the General Assembly, the credit was expanded to include investments in businesses located both inside and outside North Carolina. However the credit was no longer allowed for investments in investment companies and was limited to investments made by individuals and small pass-through entities under the theory that these investors are not likely to invest outside a 50-mile radius of their homes.

Amendment to definition of "qualified grantee business": In order to be a business in which investments are eligible for a credit, the business must be either a "qualified business venture" or a "qualified grantee business." Both types of businesses must be registered with the Secretary of State. The definition of "qualified business venture" includes several general requirements related to the line of business, gross revenues of the business, and the organization date of the business. Prior to this act, the definition of "qualified grantee business" included a requirement that the business have received a grant or other funding in at least one of the three previous years from one of several named entities. Arguably, this definition violated the rule of uniformity since a credit is allowed only for investments in businesses that have received a grant from one of several specifically named entities, and not for investments in similar businesses that have received grants from similar entities. To address this constitutional issue, the act amends the definition of "qualified grantee business" by replacing the named entities with descriptions that would encompass the following previously named entities: the North Carolina Biotechnology Center, MCNC, and the Kenan Institute for Engineering, Technology, and Science. The only previously named entity that these descriptions do not encompass is the Technological Development Authority. It is unknown if any other entity qualifies under these descriptions.

STATE PORTS TAX CREDIT: This act extends the sunset on the tax credit for North Carolina State Ports Authority wharfage, handling, and throughput charges for one year, from January 1, 2003 to January 1, 2004. When first enacted, this credit was effective for taxable years beginning on or after March 1, 1992, and ending on or before February 28, 1996. The sunset has been extended four times.

Explanation of the credit: The State Ports Authority tax credit is allowed to a taxpayer who loads or unloads waterborne cargo from an ocean carrier at the State-owned port terminal at Wilmington or Morehead City. The credit is allowed against the taxpayer's income tax. The taxpayer may be either an individual (G.S. 105-151.22) or a corporation (G.S. 105-130.41). The amount of the tax credit is equal to the amount of wharfage, handling, and throughput

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[14] There are two exceptions to this forfeiture provision. First, if the transfer occurs as a result of the death of the taxpayer, the liquidation of the taxpayer, or certain reorganizations of the qualified business, within the one-year period, the transfer does not require forfeiture. Second, the 1998 legislation created an exception to this forfeiture provision for projects in the film industry, since it is unusual for a project in that industry in which a person might invest to last for more than five years.

charges paid to the North Carolina State Ports Authority in the taxable year that exceeds the average amount of charges paid to the Authority for the current tax year and the two previous tax years. The credit is limited to 50% of the tax imposed on the taxpayer for the taxable year. Any excess credit may be carried forward and applied to the taxpayer's income tax liability for the next five years. The maximum cumulative credit that one taxpayer may claim is $2 million.

In 1992 the General Assembly enacted the State Ports income tax credit to encourage exporters to use the two State-owned port terminals in Wilmington and Morehead City. When enacted, the credit applied to amounts paid by a taxpayer on any cargo exported at either port. In 1994, the General Assembly expanded the credit to include all amounts assessed on exported cargo, regardless of who paid the shipping costs. In 1995, the General Assembly expanded the credit to include some imports by allowing a credit for break-bulk cargo and container cargo imported at either Wilmington or Morehead City and for bulk cargo imported at Morehead City. It did not allow a credit for bulk cargo imported at Wilmington. In addition, the credit for bulk exports was then limited to bulk exports at only the Morehead City terminal. In 1996, the General Assembly expanded the State ports income tax credit to include the importing and exporting at either terminal of one specific type of bulk cargo: forest products. All imports and exports of bulk cargo at the Morehead City terminal were already covered, so the effect of this change was to allow a credit for forest product imports and exports at the Wilmington terminal. In 1997, the General Assembly extended the sunset of the State ports income tax credit from February 28, 1998 to the taxable year ending on or before February 28, 2001, and increased the maximum cumulative credit from $1 million to $2 million per taxpayer. In 2001, the General Assembly extended the sunset to January 1, 2003.

Although not defined by the relevant statutes, the various types of cargo differ as follows:

- Bulk cargo is a type of commodity that is loose and usually stockpiled. Examples of this type of commodity include coal, grain, salt, and wood chips.
- Break-bulk cargo consists of commodities that are packaged and stored on pallets or in cases that must be handled and stacked onto a ship by hand, crane, etc. Break-bulk cargo also includes machinery.
- Container cargo consists of commodities that are packaged in a metal trailer box that can be locked onto a tractor-trailer chassis and then detached and put on a ship without any other handling.

NORTH CAROLINA STATE PORTS AUTHORITY: This act clarifies and amends the fee-setting power of the North Carolina State Ports Authority in the following ways:

- Clarifies that the Authority has fee-setting authority for its services.
- Sets out statutory guidelines that the Authority must consider in setting fees for its services. These guidelines include the cost of providing service, revenue requirements, the cost of similar services at other seaports in the South Atlantic region, and any other factors the Authority considers relevant.

- Requires the Authority to report to the Joint Legislative Commission on Governmental Operations no later than 30 days after the Authority establishes or increases a fee.[15]
- Exempts the Authority's fee-setting power from the rulemaking portion of the Administrative Procedure Act.

Amend Pollution Abatement Tax Exclusion

Session Law	*Bill #*	*Sponsor*
S.L. 2002-104	**SB 1253**	**Senator Odom**

AN ACT TO PROVIDE THAT CERTAIN ANIMAL WASTE MANAGEMENT SYSTEMS SHALL NOT QUALIFY FOR SPECIAL PROPERTY CLASSIFICATION AND EXCLUSION FROM THE TAX BASE PURSUANT TO G.S. 105-275(8) AND TO DIRECT THE REVENUE LAWS STUDY COMMITTEE TO STUDY ISSUES RELATED TO THE TAX EXCLUSION, AS RECOMMENDED BY THE ENVIRONMENTAL REVIEW COMMISSION.

OVERVIEW: This act provides that an animal waste management system may not qualify for property tax exclusion as a pollution control device unless it eliminates or substantially eliminates certain discharges, emissions, and contamination. The act also requires the Revenue Laws Study Committee to study property tax exemptions for pollution control equipment. The act was recommended by the Environmental Review Commission.

FISCAL IMPACT: The State General Fund is not affected. The legislation will affect revenue from the property tax base in each county. There are currently no exclusions that have been granted to facilities, thus there are no changes in current county revenues. However, had the legislation not been enacted, potential revenue losses would have been split among counties based on the number of animal waste management systems maintained in each county. Potential losses were estimated using the total property value of the swine, poultry, and turkey facilities in a county. The potential property tax revenue losses statewide could have totaled approximately $9.9 million per fiscal year.

EFFECTIVE DATE: Property tax years beginning on or after July 1, 2002.

ANALYSIS: Since 1955, North Carolina has excluded from property taxes property used exclusively for pollution control or waste disposal. The statute specifies waste lagoons as one type of property that may qualify for property tax exclusion. Before property could qualify for exclusion, the law as of 2001 required that the Environmental Management Commission (EMC) certify that the property complies with all EMC requirements, is operated in accordance with its permit, and has as its primary purpose the reduction of pollution.

As the entity responsible for certifying property for the tax exclusion, the EMC approached the Environmental Review Commission requesting clarification of the policy conflict between the potential property tax exclusion for swine waste lagoons and spray fields and the moratorium

[15] In S.L. 2001-427, the General Assembly increased its oversight of agency setting and raising of fees by requiring an agency that wishes to establish or increase any fee to have either express authorization from the General Assembly for the amount of the fee or general authorization and to consult the Joint Legislative Commission on Governmental Operations **prior** to putting the new fee into effect. S.L. 2002-99 allows the State Ports Authority to report to Governmental Operations **after** increasing or establishing a fee.

the General Assembly has placed on constructing swine waste lagoons and spray fields unless they comply with strict environmental standards. The Environmental Review Commission recommended that the General Assembly act on this issue in 2002.

To evaluate the issue, the General Assembly sought input from the EMC, individual taxpayers, the Attorney General's Office, the Department of Revenue, and other interested parties. There was testimony from experts that in the 1950s when the statute was enacted, there was much less use of animal waste lagoons and spray fields than there is today, indicating that the policy established in the 1950s may no longer be appropriate. The Department of Revenue noted that spray fields are not used exclusively for waste disposal and thus appear to be ineligible for the property tax exclusion. The Southern Environmental Law Center commented that, because waste lagoons do not reduce pollution and in fact accelerate air pollution, they do not meet the statutory requirement for exclusion that their primary purpose is the reduction of pollution. The EMC pointed out that since 1997 the General Assembly has maintained a moratorium on the construction of swine waste lagoons and spray fields with an exception only for swine waste management systems that meet the following environmental performance standards:

1. Eliminate the discharge of animal waste to surface waters and groundwater through direct discharge, seepage, or runoff.
2. Substantially eliminate atmospheric emissions of ammonia.
3. Substantially eliminate the emission of odor that is detectable beyond the boundaries of the parcel or tract of land on which the farm is located.
4. Substantially eliminate the release of disease-transmitting vectors and airborne pathogens.
5. Substantially eliminate nutrient and heavy metal contamination of soil and groundwater.

The General Assembly resolved the conflict between the moratorium and the tax exclusion by providing in this act that an animal waste management system may not qualify for the property tax exclusion unless the EMC determines that it meets the same five standards listed above. This requirement will ensure that the property tax exclusion is allowed only for animal waste management systems that meet strict environmental performance standards. This change becomes effective beginning with the 2002 property tax year.

The act also directs the Revenue Laws Study Committee to study the property tax exclusions for various types of property used for environmental reasons, in consultation with representatives of cities and counties. The Committee is directed to report the results of its study to the 2003 General Assembly.

Revenue Law Enforcement Enhancements

Session Law	*Bill #*	*Sponsor*
S.L. 2002-106	**SB 1218**	**Senator Dalton**

AN ACT TO IMPROVE THE ENFORCEMENT OF TAX LAWS BY CRIMINALIZING OR INCREASING THE PENALTY FOR CERTAIN FORMS OF TAX FRAUD AND BY ALLOWING THE DEPARTMENT OF REVENUE TO DISCLOSE CERTAIN INFORMATION TO LAW ENFORCEMENT AGENCIES.

OVERVIEW: This act improves the enforcement of tax laws by allowing for enhanced punishment when an income tax return preparer aids or assists in the filing of false or fraudulent documents with the Department of Revenue, by creating an offense for fleecing taxpayers, and by allowing the Department of Revenue to share information concerning the commission of any offense with appropriate state or federal law enforcement agencies. This act was a recommendation of the Revenue Laws Study Committee.

FISCAL IMPACT: The cost of additional court trials and prison beds due to the increased felonies is as follows:

FISCAL YEAR	COST
2002-2003	$ 9,035
2003-2004	$ 94,395
2004-2005	$204,839
2005-2006	$294,200
2006-2007	$388,752

EFFECTIVE DATE: The sections allowing for enhanced punishment and creating a new offense become effective December 1, 2002, and apply to actions committed on or after that date. The section allowing disclosure between the Department of Revenue and appropriate State or federal law enforcement agencies became effective September 6, 2002.

ANALYSIS: Under sections 1 through 3 of this act, beginning December 1, 2002, an income tax return preparer who aids or assists in the filing of false or fraudulent documents will be guilty of a Class F felony, if the amount of tax fraudulently avoided in one taxable year on all returns is less than $100,000. If the total amount of tax fraudulently avoided in one taxable year on all returns equals or exceeds $100,000, the income tax return preparer will be guilty of a Class C felony. These punishments are the same as the punishments for embezzlement under Article 18 of Chapter 14 of the General Statutes. The act incorporates the definition of "income tax return preparer" used under the Internal Revenue Code, and makes a conforming change in G.S. 105-159.1(e) to incorporate this definition.

Under the law in effect until December 1, 2002, it is a Class H felony to aid, assist, procure, counsel, or advise the preparation, presentation, or filing of a return, affidavit, claim, or other document that is fraudulent or false as to any material matter. The Department of Revenue requested the enhanced punishment because of the increasing number of fraudulent return cases involving an income tax return preparer. According to the Department, these cases generally involve income tax return preparers that intentionally inflate the itemized deductions claimed on a return or include fictitious business losses on the return. This fraud is carried out in order to reduce taxable income, thereby reducing tax liability. The Department has also noticed an increase in the number of fictitious returns. These are returns that are based on fictitious wage and tax statements.

Under section 4 of this act, beginning December 1, 2002, it will be a Class F felony for a person to receive money from a taxpayer with the understanding that the person would remit the money to the Secretary of Revenue for application on a tax liability and then willfully fail to remit the money to the Secretary. The Department reported that several times a year it will have a situation where an accountant receives money from a taxpayer to satisfy a sales or withholding tax liability. The accountant then files a fraudulent return showing reduced or zero tax due and then pockets the taxpayer's money. Although the Department can and does bring

charges against the accountant for filing a fraudulent return, the taxpayer still owes the money that he or she has lost. The taxpayer must then get the local district attorney to file embezzlement charges. The district attorneys have indicated that they prefer that the Department handle this situation since it involves taxes and since the Department is already involved. By creating the offense for fleecing taxpayers, this act places the remedy with the Department. The penalty is the same as for embezzlement totaling less than $100,000.

Section 5 of this act allows the Department of Revenue to share information it discovers during a criminal investigation of a taxpayer with appropriate State or federal law enforcement agencies. Under prior law, the Department could only provide information concerning a tax imposed by Article 2A, 2C, or 2D of the revenue laws to law enforcement agencies. These Articles deal with the tobacco products tax, alcoholic beverage license and excise taxes, and unauthorized substance taxes. However, the Criminal Investigation Division of the Department occasionally discovers evidence of criminal activity unrelated to the taxes imposed in these Articles. Under prior law, the Department was not allowed to disclose that information to law enforcement. This act alleviates this prohibition.

Contracts to Reimburse Fuel Tax/Fuel Tax Chg.

Session Law	*Bill #*	*Sponsor*
S.L. 2002-108	**SB 1407**	**Senator Kerr**

AN ACT TO ESTABLISH A CONTRACT RIGHT REGARDING THE TIMING OF PAYMENTS UNDER CONTRACTS REQUIRING REIMBURSEMENT OF FEDERAL FUEL EXCISE TAXES AND TO MAKE VARIOUS MOTOR FUEL EXCISE TAX CHANGES.

OVERVIEW: This act gives local distributors a contract right to delay reimbursing federal fuel tax to the supplier until one day before the supplier is required to remit the tax to the federal government. The act also converts the local government fuel tax refund to an exemption and makes several other changes to the motor fuel tax laws.

FISCAL IMPACT: The only provision with a fiscal impact is the one converting the local government fuel tax refund to an exemption. The exemption will be slightly revenue positive for local governments because of the interest earned on funds that once went to fuel tax payments before being refunded. Based on refund amounts for past years, Fiscal Research estimates the annual float gain for locals would have been $227,030 for fiscal year 2000-01 and $252,860 for fiscal year 1999-00.

EFFECTIVE DATE: The contract right provision became effective September 1, 2002. The motor fuel tax provisions become effective January 1, 2003.

ANALYSIS:

Contract Rights Regarding Tax Reimbursements

The State and federal motor fuel excise taxes are payable by the distributor, but collected and remitted to the respective tax collection agencies by the supplier. G.S. 105-449.91 gives the distributor the right to defer the remittance of any state tax to the supplier until the date the supplier, as trustee, must pay the tax to this State or to another state. This allows the distributor to retain the interest on the state tax monies until they are due for payment. Federal law does not address the distributor's right to defer the remittance of any federal tax due. The

distributor's right as to the timing of the remittance of the federal tax due to the supplier is subject to the terms of the contract between the distributor and the supplier.

Section 1 of this act provides that a contract subject to North Carolina law must afford the distributor the same election for the timing of federal tax remittance that the distributor has for state tax remittance. It provides that the distributor may elect to remit the federal tax due to the supplier one day before the tax is due to the federal Internal Revenue Service. Exercising this option allows the distributor to receive the benefit of any float associated with the federal tax monies. To exercise this right, the distributor must notify the supplier in writing of the intent to make this election and the effective date of the election. The effective date cannot be earlier than the beginning of the next federal tax quarter or 30 days after the notice of intent is received, whichever is later. To secure the receipt of the tax monies, the supplier can require security for the payment of the taxes in proportion to the amount the taxes represent compared to the security required on the contract as a whole.

In practice, this change in the law will not affect contracts between suppliers and distributors for branded fuel[16] when the contract names another state as the controlling state law. Currently, Georgia, Alabama, Mississippi, and Tennessee[17] have similar statutes. If no particular state's law is designated as controlling in the contract, then this State's law will control. If a supplier offers unbranded fuel[18] at a North Carolina terminal and a distributor lifts from that terminal rack, North Carolina law will control because the contract for the fuel is accepted in North Carolina.

This section of the act became effective September 1, 2002, and applies to contracts entered into or renewed on or after that date and to all continuing contracts that are in effect on that date and have no expiration date. It does not apply to a contract in effect on September 1, 2002 that, by its terms, will terminate on a later date; nor does it impair the obligation arising under any contract executed before September 1, 2002. Because the act did not become law until September 6, the constitutional prohibition against impairing contracts would prevent it from applying to contracts executed between September 1 and September 6 that have an expiration date.

Motor Fuel Enforcement Tax Changes

Section 2 of this act repeals the Class 1 misdemeanor for willfully and knowingly making a false statement for the purposes of obtaining or assisting someone else to obtain a credit, refund, or reduction of motor fuel tax liability. Repeal of this statute means that the general penalties in G.S. 105-236 will apply. It is a Class H felony under G.S. 105-236(7) to attempt to willfully evade a tax and it is a Class H felony under G.S. 105-236(9a) to willfully help someone else evade a tax.

A motor carrier subject to the International Fuel Tax Agreement must register with the carrier's base state and a motor carrier not subject to that Agreement must register with the Secretary of Revenue. It is unlawful for a motor carrier to operate motor vehicles in the State unless the motor carrier is registered. To indicate to enforcement officers that the carrier is properly registered, the vehicles must display identification markers, or decals. Section 3 of this act requires a motor carrier to keep records of the decals issued to it and to be able to account for those decals. Section 4 of this act establishes a civil penalty for unaccounted for decals and for

[16] Branded fuel is fuel supplied to a distributor pursuant to a contract.
[17] Tennessee collects federal and state excise tax at the rack like North Carolina.
[18] Unbranded fuel is fuel offered by a supplier at the terminal rack to any distributor who wishes to purchase it.

decals unlawfully obtained. The penalty for being unable to account for decals is $100 per decal. The penalty for displaying a decal unlawfully obtained is $1,000 per decal. The motor carrier whose vehicles display the decal and the motor carrier who obtained the decals are jointly and severally liable for the penalty.

Section 15 of this act simplifies the penalty for transporting motor fuel without a shipping document or with a false or an incomplete shipping document and the penalty for delivering motor fuel to a destination state other than the one shown on the shipping document. Under prior law, the amount of the penalty depended on whether the person against whom the penalty is assessed had previously been assessed a penalty under this statute. If the answer is "no", the amount of the penalty was $1,500. If the answer is "yes", the amount of the penalty was $7,500. To determine whether the person has previously been assessed a penalty under this statute required the enforcement officer to obtain detailed information, which the officer forwarded to the Motor Fuels Tax Division so that the Division could check its records and then assess the correct penalty. The penalty was seldom imposed because the enforcement officers could not enforce the penalty at the time the offense occurred. This section enables the enforcement officer to immediately assess the penalty by providing a flat penalty amount of $5,000.

Section 16 of this act will enable the Motor Fuels Tax Division to be able to track motor fuel transported by a tank wagon after the fuel has left the terminal. A tank wagon is a truck that has a compartment designed or used to carry at least 1,000 gallons of motor fuel.[19] Under this section, a person may not transport motor fuel by tank wagon unless the person has an invoice, bill of sale, or shipping document that contains the following information: the name and address of the person from whom the motor fuel was received, the date the fuel was loaded, the type of fuel, and the gross number of gallons loaded. The person must carry this documentation when transporting the fuel and show the documentation upon request. These requirements are similar to, but less onerous than, the requirements for motor fuel transported by a railroad tank car or transport truck.[20] A violation of this statute would be grounds for a civil penalty in the amount of $1,000.

Section 17 simplifies the penalty for dispensing, or allowing to be dispensed, non-tax-paid fuel into a highway vehicle. Currently, the amount of the penalty varies depending upon the number of gallons dispensed. However, it is often impossible to know how many gallons have been dispensed. This section simplifies the penalty by providing a fixed penalty amount of $250 per occurrence.

Biodiesel and Fuel Alcohol Tax Law Changes

Before this act went into effect, North Carolina's motor fuel tax laws addressed fuel alcohol, but not biodiesel. Both types of fuel are special fuels that may be used to operate a motor vehicle. Biodiesel fuel is a mixture of fuels derived in whole or in part from agricultural products or animal fats or wastes from these products or fats. The General Assembly became aware of a person planning to produce biodiesel fuel in North Carolina using, among other fats, discarded french fry grease from fast food restaurants. Sections 6 and 7 make existing fuel tax

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[19] Section 6 amends the term "tank wagon" to require that it be used to carry at least 1,000 gallons of motor fuel. This modification exempts trucks carrying less than that amount from the requirements imposed by this Section 16.

[20] Tank wagons would not be required to be registered, to have a tax responsibility statement, to have a machine-printed shipping document, or to have a destination state. Also, the penalty imposed on a tank wagon for failure to have the proper documentation is $1,000 as opposed to $5,000.

provisions applicable to biodiesel, and also provide that small providers of biodiesel and fuel alcohol are not subject to the bonding requirements applicable to refiners.

Under existing law, a person who produces fuel that can be used to operate a motor vehicle is considered a refiner and is subject to a $2 million bonding requirement. There are no refiners in North Carolina. However, it was anticipated that this definition and the large bonding requirement might become applicable to providers of fuel alcohol and biodiesel because it is possible that a vehicle can be operated with biodiesel alone or with fuel alcohol alone. To avoid subjecting small producers of biodiesel and fuel alcohol to the large surety bond requirements for refiners, this act provides a smaller surety bond requirement for smaller producers of biodiesel and fuel alcohol. To accomplish this, Section 6 defines a biodiesel provider and a fuel alcohol provider as a person who produces an average of no more than 500,000 gallons of biodiesel or fuel alcohol a month during a calendar year. It also excludes from the definition of "refiner" these biodiesel providers and fuel alcohol providers. Under Section 7, biodiesel providers and fuel alcohol providers are subject to a bonding requirement of no less than $2,000 and no more than $250,000. The amount of the bond is determined by the provider's average expected monthly tax liability.

Section 6 adds biodiesel to the definition of diesel fuel and adds biodiesel providers to the definition of supplier. These changes bring biodiesel within the scope of the existing fuel tax laws.

Special Mobile Equipment

Special mobile equipment is a vehicle that has a permanently attached crane, mill, ditch-digging apparatus, or similar attachment. The vehicle is driven on the highway only to get to and from a non-highway job. It is not designed or used primarily for the transportation of persons or property. Under prior State law, special mobile equipment was allowed to use dyed (untaxed) diesel fuel. However, federal law prohibited special mobile equipment from using dyed diesel fuel. This contradiction caused confusion and, as a result, operators of special mobile equipment were sometimes assessed federal penalties. Section 10 conforms North Carolina law to the federal law. Special mobile equipment will continue to be entitled to a quarterly refund of motor fuel tax paid to operate the equipment off-highway.[21]

Diverted Fuel

A person may not transport motor fuel by railroad tank car or by truck unless the person has a shipping document indicating, among other things, the destination state of the motor fuel. The tax on the motor fuel is collected at the rack based on the motor fuel tax rate of the state named on the shipping document as the destination state. The person transporting the motor fuel must deliver it to the state printed on the shipping document.

If the fuel is diverted to another state, the person transporting the fuel must notify the Secretary of Revenue of the diversion and receive a confirmation number authorizing the diversion. The state tax is owed on the fuel changes when the fuel is diverted to a different state. Under prior law, the distributor would notify the supplier of the diversion and the supplier would make the correction based on its business practices. The diversion could be accounted for in several different ways on one of four different motor fuel tax forms. The supplier's responsibility for making the correction was inconsistent with the fact that the supplier is not the party responsible for paying the tax; the supplier's tax collection obligations ended once the fuel left the terminal.

[21] G.S. 105-449.106(c).

Section 10 clarifies that North Carolina motor fuel excise tax is due on motor fuel that is diverted to this State. It also specifies that the person who authorizes the fuel to be diverted to a different state is liable for the tax owed to that state; likewise the person is entitled to a refund of the North Carolina tax paid on the fuel. The diversion corrections must be made on the backup tax form.

Motor Fuel Tax Exemption for Local Governments

Under prior law, counties and municipalities were entitled to a quarterly refund of motor fuel excise taxes paid by them during the preceding quarter. The refund was calculated at the rate equal to the amount of the flat cents-per-gallon rate plus the variable cents-per-gallon rate in effect during the quarter for which the refund was claimed, less one-cent per gallon. This act gives counties and cities an exemption in lieu of a refund. Section 11 removes counties and municipalities from the list of entities entitled to a refund and Section 13 adds them to the list of entities exempted from the motor fuel excise tax. Other entities exempted from the tax include the federal government, the State government, local boards of education, charter schools, and community colleges.

Administrative and Technical Changes

A refiner, a terminal operator, a supplier, an importer, a blender, a permissive supplier, and a distributor must file a bond with the Secretary in order to be licensed. The bond is conditioned upon compliance with the motor fuel tax laws. Whenever a license holder changes bonding companies or decides to go out of business, the license holder must notify the Secretary. After determining that all taxes and penalties due under the motor fuel tax laws have been paid, the Secretary must return the previously filed bond and notify both the bonding company and the license holder that the person is released from liability on the bond. The Motor Fuels Tax Division often receives returned mail on the notice sent to the license holder because the license holders have moved. Section 8 relieves the Division from the requirement that it notify the license holder; it need only return the previously filed bond and the notice of release from liability to the bondholder.

The Motor Fuels Tax Division must keep a record of all the license holders under the fuel tax statutes and it must send this list to all the license holders along with a monthly update. Many license holders have expressed a desire not to receive the list this often. Section 9 relieves the Division of the necessity of sending the monthly updates to all license holders. Under this section, the Division must send an annual list to each license holder of all the license holders. Thereafter, the Division need send a monthly update only to each licensed refiner or licensed supplier and to any other license holder that requests a copy of the list.

Section 6 includes within the definition of "motor fuel transporter" a person who transports motor fuel by pipeline. Sections 12 and 14 correct incorrect terminology.

Secure Local Revenues

Session Law	*Bill #*	*Sponsor*
S.L. 2002-120, as amended by Section 65 of S.L. 2002-159	**HB 1490**	**Representative Gibson**

AN ACT TO PROVIDE THAT LOCAL REVENUES MAY NOT BE WITHHELD OR IMPOUNDED BY THE GOVERNOR AND TO CLARIFY THE FRANCHISE TAX ON ELECTRIC POWER COMPANIES.

OVERVIEW: This act provides that certain shared tax revenues are local revenues and may not be withheld or reduced by the Governor and that funds otherwise committed to local governments may not be reduced unless all other revenue sources, including treasury surplus, have been exhausted. The act also clarifies that an electric power company that pays the annual franchise or privilege tax is not subject to an additional franchise or privilege tax imposed by a city or county.

FISCAL IMPACT: No estimate available. This legislation has no direct impact on the budget passed by the General Assembly, as these shared revenues have not been used in the legislative process for state expenditures. However, the legislation could limit the options available to the Governor in future years.

EFFECTIVE DATE: This act became effective September 24, 2002. It applies prospectively only and does not apply to pending litigation or claims that accrued prior to September 24, 2002.

BACKGROUND: For the last two years, the Governor has withheld reimbursement funds from local governments, and he recommended suspending additional reimbursement funds for fiscal year 2002-03 as well. Specifically, in fiscal year 2000-2001 the Governor placed in escrow $95 million of inventory tax reimbursement funds, representing one-half of the total annual payment, in anticipation of a budget shortfall. These funds were later released, however, to local governments. In fiscal year 2001-2002, the Governor again withheld $95 million in inventory tax reimbursement funds plus $114 million in state-shared taxes and the homestead reimbursement in order to balance the budget as of June 30, 2002.

By withholding these funds despite the statutory directive to distribute the funds to local governments, the Governor has invoked his constitutional authority pursuant to Section 5(3) of Article III of the North Carolina Constitution to balance the budget. Section 5(3) of Article III of the North Carolina Constitution sets out the Governor's budgetary duties. Specifically, it directs the Governor to prepare and recommend to the General Assembly a comprehensive budget of the anticipated revenue and proposed expenditures of the State for the ensuing fiscal period. Furthermore, it provides that the State may not operate at a deficit during the fiscal period covered by a budget. To ensure that the State does not incur a deficit, the Constitution requires the Governor to continually survey the collection of revenue. If, as a result of his surveys, he determines that actual receipts for the fiscal period, when added to the surplus remaining in the State Treasury, will not be sufficient to pay budgeted expenditures, the Governor must effect the necessary economies in State expenditures to keep the deficit from occurring. Arguably, the distribution of monies to local governments is a "State expenditure," and the Governor's constitutional obligation to maintain a balanced budget overrides the statutory directive to distribute the funds.

Based on the current information available, it is unclear whether this legislation will be effective in preventing the Governor from withholding these funds from local governments. If the Governor withholds the funds despite the enactment of this legislation, enforcement of this limitation on the Governor's authority may have to be resolved by a court. As of October 2002,

several counties and municipalities have initiated or are considering initiating lawsuits challenging the Governor's withholding of funds.[22]

ANALYSIS: Sections 1 through 7 of this act limit the Governor's budgetary authority to withhold or reduce local revenues and to reduce certain State expenditures as follows:

Tax-Sharing Statutes

Sections 1 through 6 of this act amend the tax-sharing statutes by characterizing the portion of the revenue distributed to cities and counties as distributions of "local revenue" rather than "State expenditures" for purposes of interpreting Section 5(3) of Article III of the North Carolina Constitution. Section 5(3) of Article III of the North Carolina Constitution sets out the Governor's duties and the scope of authority with regard to balancing the budget. Arguably, since the Constitution authorizes the Governor to reduce only "State expenditures," the classification of these shared tax revenues as "local revenues" prohibits the Governor from reducing or withholding the distributions. Moreover, each of the tax-sharing statutes has been amended to expressly state that the Governor may not reduce or withhold these distributions.

Tax-sharing statutes are a source of "financial aid" for local governments. Under these tax-sharing statutes, cities or counties, or both, receive a portion of certain taxes levied by the State. The shared tax revenues are derived from the levy of the following taxes:

- Beer and wine taxes[23]
- Franchise gross receipts tax[24]
- Piped natural gas tax[25]
- Sales tax on telecommunications[26]
- Powell bill funds[27]

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[22] As of November 2002, one of the pending cases is *Cabarrus County, et al. v. Tolson*, Wake County Superior Court Case No. 02 CVS 12518.

[23] Cities and counties in which beer and wine may be sold receive a portion of the State excise tax levied on beer and wine. They receive a percentage of the net amount of excise taxes collected, and the percentage depends on the type of beverage sold: 23 ¾% for beer, 62% for unfortified wine, and 22% for fortified wine. The local governments that share in the proceeds do so on a per capita basis, with counties receiving credit for their nonmunicipal population only.

[24] The State levies a gross receipts tax on electric power companies at a rate of 3.22%. From these proceeds, each city or town is entitled to an amount equal to 3.09% of gross receipts arising from sales within that city or town. Most cities receive their share of franchise tax revenue under G.S. 105-116.1. However, there are approximately 51 cities that own their own electric generation and distribution systems. These cities pay tax and receive their distribution under a separate statute – G.S. 159B-27 – but at the same rate as other cities.

[25] The State levies an excise tax on piped natural gas, and the rate is based on the monthly volume of natural gas received by the final user. The rate decreases as the amount of therms of piped gas consumed in a month increases. Cities receive 50% of the proceeds of the tax attributable to that city.

[26] The State imposes a 6% sales tax on telecommunications. The cities receive 18.26% of the net proceeds of the taxes collected minus a "freeze deduction" amount totaling $2,620,948.

[27] North Carolina's state gasoline tax is 17 ½ cents per gallon, plus the greater of 7% of the average wholesale price or 3.5 cents per gallon. Of this, an amount equal to the proceeds of 1.75 cents per gallon plus an additional 6.5% of the net proceeds of the North Carolina Highway Trust Fund is distributed among North Carolina's cities and towns. The legislation that first established this distribution system is known as the *Powell Bill*, after its principal sponsor, and the monies distributed to the cities and

Funds Appropriated or Otherwise Committed to Local Governments

Section 7 of the act limits the Governor's authority to reduce funds that the General Assembly has "appropriated or otherwise committed to local governments" by amending the Executive Budget Act to require that the Governor exhaust all other sources of revenue first, including any surplus in the treasury at the beginning of the fiscal period. This section takes a different approach than the sections dealing with the tax-sharing statutes. Under this section, the Governor is required when balancing the budget to prioritize the reduction of certain State expenditures by reducing the funds distributed to local governments only as a last resort. Under the previous sections, the General Assembly removed the local portion of shared tax revenues from the scope of the Governor's budgetary authority by stating they are not "State expenditures," and thus not capable of being reduced by the Governor under any circumstances.

Section 7 of this act was primarily intended to restrict the Governor's ability to withhold reimbursement money. State reimbursements are amounts distributed to local units to compensate them for revenue lost as the result of the removal by the General Assembly of property from the local sales and use tax base, the property tax base, or the intangibles tax base. The reimbursement programs include reimbursements for the repeal of the property tax on inventories and on poultry and livestock, the repeal of the intangibles tax, the homestead exemption from property tax, and the repeal of local sales and use taxes on food purchased with food stamps. However, Section 30A.1 of The Current Operations, Capital Improvements, and Finance Act of 2002. (S.L. 2002-126) repeals all of the State reimbursement payments to local governments, effective July 1, 2002. Nevertheless, funds "appropriated or otherwise committed to local governments" would also include:

- Low wealth school money.
- Earmarking of corporate income tax money for Public School Building Capital Fund.
- Scrap tire disposal tax.
- White goods disposal tax proceeds.
- Aid to public libraries.
- Certain grant monies.

Clarify Taxation of Electric Power Companies

Section 8 of this act clarifies that an electric power company that has collected and remitted to the State the annual franchise gross receipts tax may not be subject to any additional franchise or privilege tax imposed upon it by any city or county.

This clarification was primarily the result of responses by some cities to the seizure by the Governor of funds that would have otherwise been distributed to the cities as shared tax revenues. In response to the seizure, some cities enacted ordinances imposing their own franchise or privilege tax on electric power companies to recapture their lost revenue. This provision is intended to prevent the electric power companies from being taxed by both the State and the municipalities.

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towns are generally known as Powell Bill funds. The use of these funds by municipalities is restricted to maintaining, repairing, constructing, reconstructing or widening streets, sidewalks, bridges, curbs and gutters, bikeways, and other necessary appurtenances within the corporate limits of the municipality.

Local Sales Tax Acceleration

Session Law	*Bill #*	*Sponsor*
S.L. 2002-123	**SB 1292**	**Senator Kerr**

AN ACT TO ACCELERATE THE ADDITIONAL ONE-HALF CENT LOCAL OPTION SALES AND USE TAX AND TO MAKE CONFORMING AND TECHNICAL CHANGES.

OVERVIEW: This act accelerates the effective date of the third half-cent local option sales tax from July 1, 2003, to December 1, 2002.

FISCAL IMPACT: There is no General Fund impact. The total estimated potential revenue available to local governments from this additional half-cent if all 100 counties were to enact the tax in December 2002 is approximately $188.1 million. After deductions for administration by the Department of Revenue, the amount is reduced to $187.8 million. However, since the act is permissive and counties can decide to enact the tax at any time, no exact fiscal estimate is possible.

EFFECTIVE DATE: The act became effective September 26, 2002, but local units cannot levy the sales tax itself until December 1, 2002.

ANALYSIS: In 2001, the General Assembly authorized counties to levy additional local sales taxes of ½%, effective July 1, 2003. Under this act, the tax may become effective as early as December 1, 2002. To accomplish the sales tax acceleration, the act provides for the following:

- It allows the counties to enact the tax for the first two months (December 2002 and January 2003) with a shortened notice to the Department of Revenue. Under general law, a county must give the Secretary of Revenue at least 90 days' advance notice of a new tax levy or tax rate change; and a new tax levy or a tax rate change may become effective only on January 1 or July 1. This act provides for an expedited levy. If the county enacts the tax to become effective on or before January 1, 2003, the county must give the Secretary only 30 days' advance notice of the tax levy. Thereafter, the current law requirements of 90 days' notice and a January 1 or July 1 effective date are reinstated.
- It authorizes the Department of Revenue to withhold up to $275,000 for 2002-2003 to cover its excess nonrecurring costs for implementing the new sales tax on short notice.
- It exempts the Department of Revenue from the public contract bidding requirements for the procurement of supplies, materials, equipment, and contractual services related to the provision of notice and the development of computer software necessitated by the expedited provisions of the act.
- It provides that a retailer is not liable for the additional ½% tax levied by counties effective December 1, 2002, that it fails to collect from purchasers due to an inadvertent error during the month of December 2002 if the retailer can demonstrate to the Secretary the reason for the inadvertent error.

The act does not make the following changes to the law:

- It does not accelerate the State ½% sales tax repeal that is effective July 1, 2003. Therefore, there may be a 7% sales and use tax rate in counties that impose the additional ½% sales tax rate from December 1, 2002, until July 1, 2003.

- It does not accelerate the local sales tax distributions from quarterly to monthly. Under current law, counties are authorized to levy up to 2% local sales and use taxes[28]. All counties levy the maximum rate. The State collects the tax and distributes it quarterly to the counties and municipalities. In 2001, the General Assembly provided that local sales taxes must be distributed monthly rather than quarterly, effective July 1, 2003.
- This act does not provide a local government hold-harmless provision. Section 30A.1 of The Current Operations, Capital Improvements, and Finance Act of 2002. (S.L. 2002-126) repealed all of the State's reimbursement payments to local governments, effective beginning with the 2002-2003 fiscal year.[29] The 2001 legislation provided local governments "hold harmless" payments beginning in 2003-2004 if the amount they could potentially realize from the levy of the half-cent sales tax was less than the amount they would lose from the reimbursements. This act neither accelerates the hold harmless provision nor provides another.

Current Operations, Capital Improvements, and Finance Act of 2002

Session Law	*Bill #*	*Sponsor*
S.L. 2002-126	**SB 1115**	**Senator Plyler**

AN ACT TO MODIFY THE CURRENT OPERATIONS APPROPRIATIONS ACT OF 2001 AND TO MAKE OTHER CHANGES IN THE BUDGET OPERATION OF THE STATE.

OVERVIEW, DESCRIPTION, EFFECTIVE DATES, AND FISCAL IMPACT:

Section	*Description and Effective Dates*	*Fiscal Impact*
30A.1	**Local Government Revenues** Accelerates the repeal of the tax reimbursements from July 1, 2003, to July 1, 2002. Also authorizes local governments to raise or lower property taxes between July 1 and the following January 1 to account for unanticipated revenue increases or decreases.	This will produce a General Fund revenue gain of $333.4 million per year beginning in FY 2002-03.
30B.1	**Delay 2001 Tax Break: Elimination of Marriage Penalty for Standard Deduction** Delays the enactment by one year of the tax break enacted in 2001 eliminating the marriage penalty in the standard deduction, originally effective beginning with the 2002 tax year. Now, the standard deduction for married filing jointly	The net gain to the General Fund as the result of delaying the first $500 increase is $31.9 million for FY 2002-03. For the $6,000 standard deduction delayed until 2004, the General Fund will gain $12.6 million that year.

[28] Mecklenburg County is authorized to levy up to 2 ½% local sales and use taxes.
[29] The Appropriations Act of 2001 (S.L. 2001-424, Section 34.15) provided that the reimbursements would be repealed effective for the 2003-04 fiscal year. The Current Operations, Capital Improvements, and Finance Act of 2002 (S.L. 2002-126, Section 30A.1) accelerated that repeal.

Section	Description and Effective Dates	Fiscal Impact
	taxpayers will increase from $5,000 to $5,500 in tax year 2003, and then to $6,000 in tax year 2004.	
30B.2	**Delay 2001 Tax Break: Increase of Tax Credit for Children** Delays the enactment by one year of the increased tax credit for children enacted in 2001. Beginning with tax year 2003, the tax credit for children is increased from $60 to $75 per child and then to $100 in tax year 2004.	The delay will eliminate the $19.8 million General Fund loss originally projected for FY 2002-03 and result in a General Fund revenue gain of an equal amount. There will be a revenue gain of $34.9 million in FY 2003-04.
30C.1	**Update IRC Reference** Updates the Internal Revenue Code reference from January 1, 2001 to May 1, 2002, with exceptions for accelerated depreciation and the estate tax credit. This update conforms North Carolina law to federal law with regard to recent pension tax changes, education initiatives, the increased estate tax exemption limitations, and the extension of the carryback period for net operating losses for tax years ending 2001 and 2002.	The following General Fund revenue loss is expected[30]: FY2002-03 $16.9 million FY2003-04 $25.5 million FY2004-05 $49.7 million FY2005-06 $76.9 million FY2006-07 $77.3 million

[30] These estimates do not reflect conformity to the increased estate tax exemption limitations. See summary for Section 30C.3 of S.L. 2002-126 for fiscal impact of the estate tax law changes.

Section	Description and Effective Dates	Fiscal Impact
30C.2	**Accelerated Depreciation Provisions** Decouples North Carolina law from federal law by requiring taxpayers to add back to federal taxable income a percentage of the additional 30% accelerated depreciation allowed under federal law, effective for taxable years beginning on or after January 1, 2002. Taxpayers will continue to be able to deduct the same amount of an asset's basis under both federal and State law, but the timing of the deduction will differ.	The impact of the changes is essentially revenue neutral over the long-term since the conformity deals with an acceleration of depreciation, not the total amount of the deduction over the life of an asset. Thus, there will be substantial revenue losses starting in FY 2006-07. The General Fund impact is estimated as follows: FY2002-03 $38.2 million FY2003-04 $8.6 million FY2004-05 -$60.8 million FY2005-06 - 0 - FY2006-07 - 0 -
30C.3	**Estate Death Tax Credit Provision** Decouples North Carolina law from the phase-out of the state death tax credit under federal law, effective for estates of decedents dying on or after January 1, 2002. This provision sunsets for decedents dying on or after January 1, 2004.	Although decoupling from the phase-out of the state death tax credit avoids the loss of revenue from full conformity to the federal phase-out of the credit for state death taxes, there is an overall net loss because the act conforms North Carolina estate tax law to the increased federal estate tax exemptions: FY2002-03 $5.5 million FY2003-04 $7.3 million FY2004-05 $3.8 million FY2005-06 $0
30C.5	**Federal Gift Tax Annual Exclusion** Conforms the North Carolina gift tax exclusion to the federal inflation-adjusted gift tax exclusion used by the federal government, effective January 1, 2002.	The General Fund revenue loss is estimated as follows: FY2002-03 $0.2 million FY2003-04 $0.2 million FY2004-05 $0.2 million

Section	Description and Effective Dates	Fiscal Impact
		FY2005-06 $0.4 million FY2006-07 $0.4 million
30D.	**Unauthorized Substance Tax Expenses** Provides that local governments will bear 70% of the State's expenses in collecting the unauthorized substance tax, effective June 30, 2002. The expenses are drawn from local sales tax distributions. This section does not, however, change the amounts that are distributed to local law enforcement agencies.	The General Fund will be reimbursed for 70% of the Unauthorized Substance Tax Division's operating expenses resulting in an annual gain of $900,000.
30E.	**Insurance Regulatory Charge** Sets the insurance regulatory charge, which is assessed on the premiums tax paid by insurers, at 6.5% for the 2002 calendar year. The revenue generated by this charge is used to reimburse the General Fund for appropriations to the Department of Insurance to pay expenses incurred in regulating the industry.	The charge is expected to generate $25 million for FY 2002-03.
30F.	**Regulatory Fee for Utilities Commission** Sets the public utility regulatory fee at 0.1% for FY 2002-03. It also sets the electric membership corporation regulatory fee at $200,000 for FY2002-03. These are the same as the 2001 rates.	This fee, which funds the operations of the Utilities Commission and the Public Staff, is expected to produce $11,700,238 for FY 2002-03.
30G.1	**Close Corporate Tax Loophole: Broaden Definition of Business Income** Broadens the definition of "business income" to include all income that states can apportion for corporate income tax purposes under the U.S. Constitution, effective with taxable years beginning on or after January 1, 2002.	The General Fund revenue gain is estimated as follows: FY2002-03 $70.0 million FY2003-04 $50.0 million FY2004-05 $53.7 million FY2005-06 $56.7 million FY2006-07 $59.5 million
30G.2	**Close Corporate Tax Loophole: Equalize Franchise Tax on Corporate-Affiliated LLCs** Tightens 2001 legislation intended to close a loophole that allows corporations to escape franchise tax by transferring assets	The General Fund revenue gain is estimated as follows: FY2002-03 $20.0 million FY2003-04 $21.2 million FY2004-05 $22.5 million FY2005-06 $23.8 million

Section	Description and Effective Dates	Fiscal Impact
	to a controlled LLC, effective beginning with payments due in March 2003.	FY2006-07 $25.2 million
30H.	**Housing Tax Credit** Enlarges the class of taxpayers eligible for an enhanced credit for investing in low-income housing in a county that sustained severe or moderate damage from a hurricane in 1999 by backdating the effective date for eligibility from 2001 to 2000.	Assuming the project investors use 100% of the available tax credit, the annual General Fund loss is $2.15 million for Fiscal Years 2002-03 to 2006-07.
30I.	**No Estimated Income Tax Penalty for 2002 Tax Year** Provides that no estimated income tax penalty applies for the 2002 tax year to the extent the underpayment was created or increased by a provision of this act	

ANALYSIS:

LOCAL GOVERNMENT REVENUES

In 2001, the General Assembly repealed all of the State's reimbursement payments to local governments, effective beginning with the 2003-2004 fiscal year. Part 30A accelerates the repeal, effective July 1, 2002.

State reimbursements are amounts distributed to local units to compensate them for revenue lost as a result of the removal by the General Assembly of property from the local sales and use tax base, the local property tax base, or the intangibles tax base. State reimbursements consist of reimbursements for the repeal of the property tax on inventories and on poultry and livestock, the repeal of the intangibles tax, the "homestead exclusion" from property tax, and the repeal of local sales and use taxes on food purchased with food stamps. This act does not repeal or reduce the distribution of local government tax-sharing revenues: excise tax on beer and wine, franchise tax on electricity, gross receipts tax on piped natural gas, sales tax on telecommunications service, and the Powell bill revenues.

Part 30A also allows counties and cities to amend their budget ordinances between July 1st and the following January 1st to increase or reduce their property tax levy to account for unanticipated revenue increases or decreases.

DELAY 2001 TAX BREAKS

In 2001, the General Assembly enacted two income tax breaks to become effective for the 2002 tax year[31]: elimination of the marriage tax penalty in the standard deduction[32] and an increased tax credit for children. Part 30B of this act delays the enactment of these tax benefits.

[31] S.L. 2001-424, as amended by S.L. 2001-476, 2001-497, and 2001-489.

[32] The so-called married tax penalty is the result of a tax system that recognizes that a married couple's living expenses are less than the expenses of two single people living separately but more than the

Delay Elimination of Marriage Tax Penalty for the Standard Deduction: In 2001, the General Assembly reduced North Carolina income taxes on married couples that claim the standard deduction[33] by increasing the amount of the standard deduction for married filers so that it would be twice that of a single taxpayer. Since 1989, the basic standard deduction for a single person in North Carolina has been $3,000 while that for a married couple filing jointly has been $5,000. The increase in the deduction enacted in 2001 was to be phased in over the 2002 and 2003 tax years. The standard deduction for married persons filing separately is one-half that for a married couple filing jointly, so the 2001 act also phased it up from $2,500 to $3,000 over the 2002 and 2003 tax years. Part 30B of this act delays by one year the phase-in of the increased deduction, so that it will occur over the 2003 and 2004 tax years.

Delay Increase in Tax Credit for Children: In 2001, the General Assembly increased the $60 tax credit per child to $75 for the 2002 tax year and to $100 for the 2003 tax year. Part 30B of this act delays the phase-in of the credit increase until the 2003 and 2004 tax years. The 1995 General Assembly enacted the tax credit of $60 per child for taxpayers who have dependent children and have family adjusted gross income below $100,000 for a married couple and $80,000 for a head of household. Neither the 2001 act nor this act changes the income thresholds. The credit is in addition to the federal and state tax credits or exclusions for child care expenses. The credit is allowed for each dependent child for whom the eligible taxpayer could take a federal personal exemption under section 151(c)(1)(B) of the Internal Revenue Code. That Code section allows an exemption for each dependent child who either is less than 19 years old at the end of the taxable year or is a student and is less than 24 years old at the end of the taxable year. A child is a son, stepson, daughter, or stepdaughter. A dependent child is a child over half of whose support is provided by the taxpayer.

UPDATE IRC REFERENCE

North Carolina's tax law tracks many provisions of the federal Internal Revenue Code, by reference to the Code.[34] The General Assembly determines each year whether to update its reference to the Internal Revenue Code.[35] Updating the Internal Revenue Code reference makes recent amendments to the Code applicable to the State to the extent that State law previously tracked federal law. The General Assembly's decision whether to conform to federal

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expenses of one single person. In addition, if one spouse is not employed full-time, a married couple's income would be less than that of two comparable single people who work full-time, but more than that of one single person. The tax law addresses these situations through the tax brackets, the personal exemptions, and the standard deduction. The result of these tax provisions is that a married couple with only one spouse working experiences a tax reduction when they marry, a married couple where one spouse earns substantially more than the other experiences no tax reduction or increase when they marry, and a married couple with both spouses earning roughly the same amount experience a tax increase when they marry.

[33] Roughly 70% of North Carolina taxpayers claim the standard deduction.

[34] 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.

[35] 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."

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.

Congress enacted two bills that have changed the Code significantly since January 1, 2001:

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), enacted on June 7, 2001, includes numerous changes to the taxation of pension benefits, accounts, distributions, and rollovers; of education initiatives; and of estates. All of the provisions of EGTRRA will expire on December 31, 2010, unless the provisions are renewed or modified by Congressional action.[36]

The federal Job Creation and Worker Assistance Act of 2002, enacted March 9, 2002, includes an accelerated 30% bonus depreciation allowance for certain assets placed in service after September 10, 2001, and before September 11, 2004, and an extension of the carryback period for net operating losses occurring in tax years ending in 2001 and 2002 from two years to five years.

Both of these acts will substantially affect a taxpayer's federal taxable income. Since North Carolina begins its corporate and individual income tax calculations with federal taxable income, these acts also have a substantial impact on North Carolina's tax revenues to the extent the State chooses to conform to those changes.

Part 30C of this act rewrites the definition of the Code to change the reference date from January 1, 2001, to May 1, 2002. It then provides that a taxpayer must add to federal taxable income the amount allowed as an accelerated depreciation deduction under section 168(k) or 1400L of the Code and that a taxpayer's estate tax liability is determined without regard to the phase-out of the state death tax credit. In effect, Part 30C would do the following:

- Conform to all of the pension tax changes in the Code.
- Conform to all of the education initiatives in the Code.
- Conform to the increased estate tax exemption limitations.
- Not conform to the phase-out of the state death tax credit.
- Conform to the extension of the carryback period for net operating losses occurring in tax years ending in 2001 and 2002.
- Delay the accelerated 30% bonus depreciation allowance.

Pension Tax Provisions: Part 30C conforms North Carolina's tax treatment of pension benefits and distributions to federal law. EGTRRA made the following notable changes to the pension laws:

- It allows taxpayers to contribute more to their tax-deferred retirement accounts. It gradually increases the amount that may be contributed to a 401(k), 403(b), and 457 accounts between 2002 and 2006. The contribution limit will increase to $15,000 in 2006. Starting in 2007, the limit will be indexed for inflation in $500 increments. It also allows persons who are 50 or older to make an additional catch-up contribution to their tax-deferred retirement accounts.
- It increases the amounts that may be contributed to both traditional IRAs and Roth IRAs from $2,000 in 2001 to $3,000 in 2002. This amount gradually increases to $5,000

[36]The Congressional Budget Act of 1974 mandates this sunset provision.

for 2008. After 2008, this amount will be indexed annually for inflation. It also allows people over the age of 50 to make catch-up contributions to an IRA.

- It modifies the distribution rules for governmental 457 plan participants so that their deferred compensation funds will be taxed when they receive the distribution, not when it is made available to them.
- It repeals the coordination of deferrals between 457 and other elective deferral plans. Under former law, the maximum deferral amount for a 457 plan was reduced dollar for dollar by any contribution made to other types of retirement plans. The tax law change means that a person may defer the maximum annual contribution limit to a 457 plan as well as the maximum amount in a 401(k) or 403(b) plan.
- It expands the types of eligible tax-free rollover distributions to include distributions from qualified plans, 403(b) annuities, and 457 plans to other such plans and distributions from IRAs to qualified plans, 403(b) annuities, and 457 plans.
- It allows a surviving spouse to roll over distributions from a deceased spouse's plan to his or her own plan. Prior to this change, the tax-free rollover had to be made to an IRA.

Education Tax Provisions: Part 30C conforms North Carolina tax law on education incentives to the federal changes enacted last year. The more notable tax changes affecting education incentives include:

- It increases the annual maximum contribution limit to an Education IRA from $500 to $2,000 per beneficiary.
- It allows education IRA dollars to be used to cover expenses of students in grade, middle, and high schools.
- It eases the restrictions and limitations when using an Education IRA with other education initiatives, such as the Hope or Lifetime Learning tax credit.
- It moves the annual contribution deadline for Education IRAs from December 31 to April 15 of the following year.
- It provides that distributions from Section 529 Plans will be income-tax free up to the amount that is used to pay qualified higher education expenses.[37] Under former law, participants enjoyed only the benefit of tax-deferred contributions and investment growth.
- It allows a person to transfer 529 plan credits from one program to another for the benefit of the same beneficiary without incurring a taxable event.
- It extends the deduction for employer-paid college expenses to include graduate courses.

Estate Tax Provisions: North Carolina repealed its inheritance tax in 1998, effective for deaths occurring on or after January 1, 1999. It replaced its inheritance tax with an estate tax that is equivalent to the federal state death tax credit allowed on a federal estate tax return. This type of state estate tax is known as a "pick-up" tax because it picks up for the state the

[37] North Carolina currently allows tax-free distributions for North Carolina plans. Section 30C.4 of this act repeals the State deduction.

amount of federal estate tax that would otherwise be paid to the federal government.[38] EGTRRA made two changes that affect the estate tax:

- It phases out the estate tax over the next eight years by increasing the exclusion amount from $675,000 in 2001 to $1 million in 2002-03, $1.5 million in 2004-05, $2 million in 2006-08, and $3.5 million in 2009. There is no need for an exemption amount after 2009 since the tax is repealed in 2010. However, the tax is scheduled to reapply in 2011 unless a future Congress makes the repeal permanent. If the tax were reinstated in 2011, the exclusion amount would be $1 million. This act conforms North Carolina's exemption limits to the federal exemption limits to ensure that estates in North Carolina do not have to pay State tax if there is no federal tax due.
- It phases out the state death tax credit over the next four years by reducing it 25% in 2002, 50% in 2003, and 75% in 2004, and by repealing it entirely in 2005. This act does NOT conform to the phase out of the state death tax credit for two years.[39] Therefore, under this act an estate of a decedent dying on or after January 1, 2002, and before January 1, 2004, would owe North Carolina estate tax to the same extent that it would be owed without regard to the phase-out of the credit. The January 1, 2004, sunset ensures that the State will have to revisit this issue next year.

Because North Carolina's estate tax is based upon the federal credit for state death taxes, the repeal of the state death tax credit in 2005 and the ultimate repeal of the federal estate tax in 2010 will mean that the State must decide whether to replace or repeal its estate tax in the future.

Accelerated Depreciation Provisions: Under the Job Creation and Worker Assistance Act of 2002, a taxpayer is allowed an accelerated 30% bonus depreciation allowance for certain assets placed in service after September 11, 2001, and before September 11, 2004. The taxpayer is still entitled to the normal first-year depreciation on the remaining basis of the asset after reducing the basis by the bonus depreciation. This provision affects both corporate and individual income taxpayers.

The change in federal law results in a taxpayer recovering the basis in the asset sooner than under former law; however, over the life of the asset the taxpayer still receives the same benefit. This act does not conform State law to the accelerated depreciation schedule allowed under federal law.[40] However, under this act a taxpayer will continue to be able to deduct the same amount of an asset's basis under both federal and State law; it is just that the timing of

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[38] As of July 1, 2002, 37 other states, plus the District of Columbia, impose only the "pick-up tax".

[39] As of October 2, 2002 the following 10 states, in addition to North Carolina, have acted to decouple from the phase-out of the state death tax credit: Maine, Maryland, Massachusetts, Minnesota, Nebraska, New Jersey, Pennsylvania, Rhode Island, Vermont, and Wisconsin. The following 5 states, plus the District of Columbia, will remain decoupled automatically under their current law unless they take legislative action: Kansas, New York, Oregon, Virginia, and Washington.

[40] As of September 26, 2002, the following 23 states, plus the District of Columbia, which previously followed federal depreciation rules, are now decoupled as the result of explicit legislative action: Arizona, Connecticut, Georgia, Hawaii, Illinois, Indiana, Iowa, Maryland, Massachusetts, Minnesota, Mississippi (per ruling of state tax commissioner), Missouri (for one year), Nebraska, New Jersey, Ohio, Oklahoma, Pennsylvania, Rhode Island, South Carolina, Tennessee, Vermont (for corporate income tax filers only), Virginia, and Wisconsin. In addition, New York City has decoupled from the bonus depreciation allowance. Six other states are decoupled automatically under pre-existing tax law: Arkansas, Idaho, Kentucky, New Hampshire, South Dakota, and Texas.

the deduction will differ. To accomplish this decoupling from the federal accelerated bonus depreciation, the act does two things:

- For the first three years of the federal accelerated depreciation, it provides that a taxpayer must add back to federal taxable income a percentage of the additional 30% accelerated depreciation in the year the accelerated depreciation is claimed for federal purposes.[41] The percentage is 100% for the 2001 and 2002 taxable years and 70% for the 2003 taxable year. There is no add-back for the 2004 taxable year. The add-back for the first three years of the accelerated depreciation means that for State tax purposes, a taxpayer would deduct less in tax years 2001-2003 than the taxpayer would have deducted if the State conformed to the accelerated depreciation law. The amount of the deduction will be the normal first year depreciation on the remaining basis of the asset after reducing the basis by the bonus depreciation amount allowed under federal law plus 30% of the bonus depreciation in 2003. In 2004, the State will have in effect conformed to the federal law and the entire bonus depreciation may be deducted.

- In tax years beginning on or after January 1, 2005, it provides that the taxpayer may deduct from federal taxable income the total amount of the add-backs required in earlier years, divided into five equal installments. This means that for State tax purposes, a taxpayer would be allowed to deduct a greater depreciation amount in the outlying tax years – the normal depreciation amount plus 20% of the accelerated depreciation amount the taxpayer had to add back. The purpose of this recovery provision is to enable the taxpayer to have the same basis in assets for federal and State purposes. Without this deduction provision, a taxpayer would have a different basis in the depreciable asset for State and federal purposes and would have to keep separate books and records for State and federal purposes until the disposal of the asset. In effect, the add-back and subsequent deduction will affect the timing of the impact of bonus depreciation on the State but it will not increase or decrease the total amount of revenue the State receives over the affected years.

Gift Tax Change: North Carolina imposes a gift tax on property transferred during the life of a donor. Gifts to a spouse are exempt from tax. The gift tax law allows an annual exclusion of $10,000.

The federal gift tax annual exclusion is more complex. Since 1998, the $10,000 federal gift tax annual exclusion has been subject to an inflation adjustment. The adjustment happens only in increments of $1,000 however. From 1998 until 2001, inflation had not grown enough to reach the first $1,000 increment. In 2002, that threshold was reached and the federal annual exclusion increased to $11,000. This amount won't increase to $12,000 until the cumulative inflation adjustment is at least 20%.

Part 30C amends North Carolina's gift tax annual exclusion to piggyback the federal amount, effective January 1, 2002.

UNAUTHORIZED SUBSTANCE TAX EXPENSES

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[41] For tax years beginning before January 1, 2002, the add-back must be taken in the first taxable year beginning on or after January 1, 2002, so that the taxpayer will not recognize any retroactive tax increase.

Part 30D of this act allocates to local governments 70% of the State's expenses in collecting the unauthorized substance tax. The expenses would be drawn from local sales tax revenues. Under existing law, the following expenses are deducted from local sales tax distributions: costs of the Property Tax Division within the Department of Revenue, costs of the Property Tax Commission, the costs of the Institute of Government in operating a training program in property tax appraisal and assessment, and the costs of the Local Government Commission.

The General Assembly first imposed the unauthorized substances tax in 1989 to generate revenue for State and local law enforcement agencies and for the General Fund. Seventy-five percent of the tax collected is distributed to the State or local law enforcement agency that conducted the investigation that led to the tax assessment. The remaining 25% is credited to the General Fund. This act does not change this revenue allocation.

INSURANCE REGULATORY CHARGE[42]

Part 30E of this act sets the insurance regulatory charge at the same rate as last year's rate: 6.5% for the 2002 calendar year. The insurance regulatory charge is a fee that was enacted in 1991 to defray the State's cost of regulating the insurance industry. The charge is a percentage of each insurance company's premiums tax liability. The insurance regulatory charge is imposed on insurance companies, health maintenance organizations, and medical service corporations. For health maintenance organizations and medical service corporations, the fee is levied on each company's hypothetical gross premiums tax liability determined at the 1.9% gross premiums tax rate applied to its premiums base. The hypothetical calculation is necessary because medical service corporations and health maintenance organizations pay premiums tax at a lower rate.

REGULATORY FEE FOR UTILITIES COMMISSION

Part 30F of this act sets the tax rate for the public utility regulatory fee for the 2002-2003 tax year at the same rate as last year's rate: 0.1%. This rate must be set by the General Assembly each year. The utility regulatory fee is a tax that was first imposed in 1989. The proceeds of the fee are credited to the Utilities Commission and Public Staff Fund and used to defray the State's cost in regulating public utilities. The regulatory fee is imposed on all utilities that are subject to regulation by the North Carolina Utilities Commission. The fee is a percentage of the utility's North Carolina jurisdictional revenues. In general, jurisdictional revenue is revenue derived from providing utility service in North Carolina.

In addition to funding the State's cost in regulating public utilities, the money in the Utilities Commission and Public Staff Fund is currently used to finance the work of the Study Commission on the Future of Electric Service in North Carolina. The General Assembly established the Commission in 1997 to examine the cost, adequacy, availability, and pricing of electric rates and service in North Carolina to determine whether legislation is necessary to assure an adequate and reliable source of electricity and economical, fair, and equitable rates for all consumers of electricity in North Carolina. Section 14.10 of S.L. 2000-67, the Current Operations and Capital Improvements Appropriations Act of 2000, extended the life of the Study Commission and its funding from the Utilities Commission and Public Staff Fund through June 30, 2006.

Part 30F also sets at $200,000 for the 2002-2003 fiscal year the annual public utility regulatory fee imposed on electric membership corporations whose principal purpose is to furnish or cause to be furnished bulk electric supplies at wholesale. This is the same rate that

[42] See the summary for S.L. 2002-144 for additional changes made to the insurance regulatory charge.

was in effect for the 2001-2002 fiscal year. The North Carolina Electric Membership Corporation is the only electric membership corporation that fits this description. The proceeds of the fee are credited to the Utilities Commission and Public Staff Fund and used to defray the State's cost in regulating electric membership corporations.

The 1999 General Assembly authorized electric membership corporations to form subsidiary corporations that may provide energy services and products, telecommunications services and products, and water and wastewater collection and treatment. The subsidiaries must fully compensate the electric membership corporation for its use of the corporation's personnel, services, equipment, and property. The Utilities Commission is charged with regulating this aspect of the subsidiary's business and, to pay for this regulation, the 1999 legislation levied a flat-rate regulatory fee to be paid annually by the North Carolina Electric Membership Corporation. The General Assembly must establish the fee amount each year. The North Carolina Electric Membership Corporation is the only electric membership corporation whose principal purpose is to furnish or cause to be furnished bulk electric supplies at wholesale, as provided in G.S. 117-16. It is a "generation and supply cooperative" owned by its members. Its members are all but one of the existing North Carolina electric membership corporations, which are "distribution cooperatives." Thus, the fee imposed on the North Carolina Electric Membership Corporation will be passed on to its member electric membership corporations.

CLOSE CORPORATE TAX LOOPHOLES

This Part closes two corporate tax loopholes that allow some corporate profits to escape taxation and give corporate tax planners an opportunity to avoid existing taxes on corporate income and assets. The first loophole is caused by the definition of business income used in the corporate income tax law; the second loophole is caused by the different franchise tax treatment of corporations and limited liability companies.

Definition of Business Income: The first section of this Part amends the definition of "business income" to include all income that is apportionable under the U.S. Constitution, effective for taxable years beginning on or after January 1, 2002.

Corporations that do business in more than one state divide up their income among those states for income-tax purposes. Business income is apportioned based on a formula that takes into account how much sales, property, and payroll the corporation has in each state. Nonbusiness income is allocated to a state based on its connection with that state. In the most basic terms, nonbusiness income could be described as income that is earned in an unrelated sideline activity of the corporation.

As an analogy, each interstate corporation's income is in two "pies" – a business income pie that is divided up among the states in which it does business, and a nonbusiness income pie that is given entirely to the state it is connected to.

In an ideal system, all states would follow the same rules for dividing up interstate corporations' income for tax purposes, so that no more and no less than 100% of every corporation's net income would be subjected to state income tax. However, different states have different laws and even when the laws are the same, they may be interpreted differently. In theory, this can result in the taxation of more than 100%, as well as less than 100%, of a corporation's net income. In practice, corporate tax planners take the opportunity to create "nowhere" income – income that no state can tax. Instead of each state receiving its piece of the business income pie, some pieces are thrown away. Thus, although a corporation may do substantial business in

North Carolina, much of its otherwise taxable business income may be characterized as nonbusiness, so that North Carolina gets no piece of it.

These tax avoidance schemes are possible not only because different states have different laws, but also because states have laws that are vague or too narrow. In North Carolina, before this act, income was defined as business income if it related to the regular trade or business of the taxpayer. This definition is vague and narrower than what is allowed under the United States Constitution. If North Carolina was entitled to tax a significant percentage of a corporation's business income, the corporation could try to shift much of its income into the nonbusiness pie, which North Carolina does not share in. This could be true even though the corporation had deducted as a business expense the same items that it later claimed were not business items when the time came to pay tax on profits. Court decisions in North Carolina upheld this tax avoidance technique under the law prior to this act. Examples of the types of business income that corporations most often recharacterize are rents, royalties, gain or loss from the sale of property, interest, and dividends.

This Part changes the definition of business income to include any income that the United States Constitution allows a state to treat as business income. This change eliminates the prior statute's vagueness and narrowness, which allowed it to be used by corporations to create "nowhere" income that should otherwise be taxable in North Carolina. One effect of this change is to include income from extraordinary events, such as a liquidation of a division, in apportionable income. This effect is consistent with the Department of Revenue's historical position, as illustrated by its administrative rules, before the North Carolina Supreme Court's decision in *Lenox v. Tolson*.[43] A corporation's income earned out of state from unrelated business activity that makes up a discrete business enterprise will continue to be nonbusiness income that cannot be apportioned – it would continue to be allocated to the state to which it is connected.

Before this act, North Carolina was one of 26 states that used the vague, unnecessarily narrow definition of business income. Eighteen states have a broader definition of business income. Five other states have the same law as enacted by this Part (define business income as all that the U.S. Constitution allows state to apportion). Thirteen states apportion all corporate income. A state using this approach receives less revenue than if it used the approach taken by this Part, because it relinquishes the right to tax true nonbusiness income of businesses headquartered in the state. The 13 states include Georgia, South Carolina, and Virginia.

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[43] 353 N.C. 659, 548 S.E.2d 513 (S.Ct. 2001). In this case, Lenox, a New Jersey-based corporation, disposed of a subsidiary, ArtCarved, by selling all of its assets. Lenox did not retain any of the liquidation proceeds for use in its ongoing operations but distributed all of those proceeds to its sole shareholder. Lenox classified the gain from the sale as "nonbusiness income" on its North Carolina tax return and therefore did not pay taxes on the gain. The NC Department of Revenue reclassified the gain as business income and assessed corporate income tax. Lenox paid the tax under protest and sought a refund. Of the two tests used to determine business income, only the "functional test" applied to this transaction. The functional test focuses on income from property if the acquisition, management, and/or disposition of the property was an integral part of the corporation's regular business operations. The Court concluded that, under this test, a liquidation was an extraordinary event and not a recurring transaction made in the regular course of business. The Court further held that when a transaction involves a complete or partial liquidation and cessation of a company's particular line of business, and the proceeds are distributed to shareholders rather than reinvested in the company, any gain or loss generated from that transaction is nonbusiness income. In so holding, the Court expressly disavowed statements by the Court three years earlier in *Polaroid v. Offerman* with regard to its interpretation of the functional test.

LLC Franchise Tax: In 2001, the General Assembly enacted S.L. 2001-327 to close a loophole that allowed corporations to avoid franchise tax on their assets by transferring their assets to a controlled limited liability company (LLC). Corporations pay franchise tax on their assets but LLCs do not pay franchise tax on their assets. Tax planners helped many corporations avoid most of the franchise tax they would otherwise owe by setting up an LLC for the purpose of holding the assets on behalf of the corporation. Although the corporation's business continued in the same way, the corporation eliminated most of its franchise tax through this paper transaction.

The 2001 legislation tried to address this problem by requiring a corporation to pay tax on assets owned by the LLC if the corporation, including its affiliated corporations, indirectly owned[44] at least 70% of the LLC's assets. Unfortunately, tax planners found that the tax could still be avoided by using an additional paper transaction. If the corporation interposed a partnership between itself and the LLC holding its assets, then technically the 2001 legislation would not apply and the assets would continue to escape franchise tax.

The second section of this Part broadens the approach of the 2001 legislation to include "related members" (other entities and individuals) who may partner with one or more corporate entities to own the LLC to which the corporate assets are transferred. This section is effective beginning with payments due in March 2003. "Related members" is a defined term and includes shareholders, partnerships, etc.

If a corporation and its related members together indirectly own at least 70% of an LLC's assets, this Part provides that each corporation pays franchise tax on its relative share of the LLC's assets. The relative share is calculated after excluding those related members who are not corporations. Thus, the entire assets are subject to franchise tax, with the tax burden shared proportionally by the corporations that are involved in the ownership scheme.

Here is an example:

A parent corporation, its subsidiary, and a major shareholder of the parent form a partnership to own an LLC that will own assets on behalf of the parent and subsidiary. The LLC's documents provide that upon dissolution its assets are distributed as follows:

Parent Corporation:	20%
Subsidiary Corporation:	45%
Shareholder:	35%

Under prior law, the assets would remain free of franchise tax. Under the changes in this Part, the parent corporation will pay franchise tax on 31% of the assets and the subsidiary corporation will pay franchise tax on 69% of the assets. Those are their relative shares of the total once you exclude the non-corporate owner.

The approach taken by this Part is much broader than the 2001 legislation and is intended to anticipate the creative paper relationships tax planners may devise to try and avoid the franchise tax. The breadth of the provision is such that it could apply to a "legitimate" situation, such as an individual who is the sole shareholder of a corporation and who later forms an LLC with an associate. Under this Part, the corporation would pay tax on the LLC's assets. Unfortunately, there does not appear to be a way to distinguish this type of situation from one in which the corporation is manipulating relationships to avoid its franchise tax. With different

[44] Indirect ownership of an LLC's assets is determined based on who is entitled to receive those assets upon dissolution of the LLC.

tax treatment of similar entities, tax planners can try to manipulate relationships to fall into the untaxed category. Because corporations and LLCs are similar, there may not be a strong policy reason to treat them differently for franchise tax purposes.

HOUSING TAX CREDIT EFFECTIVE DATE CHANGE[45]

Part 30H of this act enlarges the class of taxpayers eligible for an enhanced credit for investing in low-income housing in a county that sustained severe or moderate damage from a hurricane in 1999. In 1999, the General Assembly enacted a new tax credit for rehabilitating or constructing low-income housing. The credit is equal to a percentage of the amount of the taxpayer's federal credit for low-income housing with respect to eligible North Carolina low-income housing. The credit is 75% for buildings located in tier one or two counties and 25% for buildings located in other tiers. In 2000, the General Assembly enacted legislation providing that the 75% credit is also allowed for buildings located in one of 26 counties that sustained severe or moderate damage from a hurricane in 1999. This increase in the amount of the credit was made effective for buildings that are allocated a federal credit on or after January 1, 2001. The federal tax credits are allocated in December of each year. Thus, those taxpayers who made investments in hurricane counties and were allocated federal credits in December 2000 are not eligible for the enhanced State credit. This act backdates the effective date for eligibility for the enhanced State credit from 2001 to 2000, thereby including those who were allocated federal credits for investments in hurricane counties during 2000.

Subsidiary Dividend Changes

Session Law	*Bill #*	*Sponsor*
S.L. 2002-136	**HB 1670**	**Representative Luebke**

AN ACT TO CLARIFY THE EXPENSE ATTRIBUTION LAW AS IT APPLIES TO DEDUCTIBLE DIVIDENDS AND TO PROVIDE LIMITS ON THE POTENTIAL TAX LIABILITY.

OVERVIEW: This act provides certainty and clarity to the expense attribution law as it applies to deductible dividends and provides limits on the potential tax liability.

FISCAL IMPACT: The act assures the State of the revenues relied upon in its budget availability estimates for 2001 and 2002. Under the act, the State may expect to receive approximately $57 million a year for 2001, 2002, and 2003 from the taxation of subsidiary dividends. Of this amount, the State expects to receive approximately $80 million in availability for the 2002-03 budget.

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

BACKGROUND: The 2001 General Assembly enacted legislation conforming State law to the federal rules for the deduction of dividends received. This change eliminated the adjustments that had previously been required to reflect differences between the federal and State dividends deduction. Eliminating the adjustments also made the dividends subject to the general State law that expenses related to untaxed income cannot be deducted from taxable income.

[45] See the summary for S.L. 2002-87 for a more complete explanation of the substantive changes made to the housing tax credit.

As a result, expenses related to deductible dividends must be netted from those dividends.[46] The law did not provide guidelines for calculating the amount of expenses that are related to deductible dividends.

Without knowing exactly how to determine the amount of related expenses, taxpayers were faced with uncertainty and potentially greater liability than they had anticipated when the legislation was debated. The new law was expected to have an especially significant impact on bank holding companies and electric power holding companies, because federal law requires them to have multiple subsidiaries.

ANALYSIS: The act provides clarity to the expense attribution law as it applies to deductible dividends and provides limits on the additional tax liability. These limits were calculated so that the act should yield revenue at least equal to what had been included in budget availability estimates based on the 2001 law.[47] The act states the intent of the General Assembly that it will be effective during 2001 and 2002 but will be studied and may be revised effective beginning with the 2003 tax year. However, the act does not sunset.

In summary, the act limits tax liability as follows:

- There are caps on the amount of related expenses that must be netted from deductible dividends as follows:
  - Most companies: 15% of dividends
  - Bank holding companies: 20% of dividends
  - Electric power holding companies: 15% of total interest expenses
- The additional tax that a bank holding company and its related companies must pay as a result of the expense netting is subject to a maximum of $11 million per corporate family.
- Bank holding company corporate families also receive a credit beginning in 2003. For bank corporate families that reach the $11 million maximum, the credit is $2 million. For other bank corporate families, the credit is equal to the amount of tax reduction that would result if bank holding companies were subject to a 15% cap rather than a 20% cap. These credits may be taken against income tax or franchise tax and are spread out over four tax years beginning in 2003.
- Electric power holding companies receive a credit equal to one-half of the additional tax that each must pay as a result of the expense netting. The credit is taken in the following year. The credit may be taken against income tax or franchise tax. As an alternative, an electric power holding company may elect to allocate the credit among

[46] North Carolina has an exception to its general law where federal and State laws differ regarding the taxability of an income item. Prior to the 2001 changes, companies were able to use the exception to deduct expenses associated with deductible dividends earned from subsidiaries. The 2001 tax law change effectively eliminated the deduction of expenses associated with subsidiary dividends.

[47] After many discussions with the Department of Revenue and the interested parties about the impact of the expense attribution rules, it became clear that the 2001 estimate of $32.8 million understated the impact of the indirect change in the expense attribution rules. The reason for the under-estimate is that the Department of Revenue's analysis of the 2001 legislation, which used confidential tax returns for the 1994 tax year and an update of the 1994 data, did not include financial institutions. The budget enacted by the 2002 General Assembly included $50 million in additional budget availability from a re-estimate of the 2001 legislation.

the members of its affiliated group. If the electric power company makes this election, then the credit is spread out over four tax years, beginning in 2003.

SECTION-BY-SECTION ANALYSIS:

Section 1:	For federal tax purposes, dividends are deductible with no adjustment for related expenses. For State tax purposes, no deduction is allowed for expenses related to nontaxable income. Therefore, for State tax purposes, an adjustment must be made to federal taxable income to add-back any related expenses that were included in the federal deduction. This section provides that not all of the expenses must be added back by establishing a different adjustment for expenses related to dividends received that are not taxed.
Section 2:	This section establishes the adjustment for expenses related to dividends received that are not taxed, by providing a cap on the amount of tax payable: 15% of nontax dividends for most companies; 20% of nontax dividends for bank holding companies; and 15% of total expenses for electric power holding companies. The act also provides a credit for bank holding companies and electric power companies. Any unused portion of the credit may be carried forward to succeeding taxable years.
Section 3:	A conforming change to ensure that related expenses are deducted only once when calculating a corporation's net economic loss.
Section 4:	A conforming change that provides the same tax treatment for foreign source dividends as domestic source dividends.
Section 5:	States the intent of the General Assembly to address the issues raised by this act during the 2003 Regular Session. The Revenue Laws Study Committee is to study the treatment of expenses related to dividends received and other income not taxed, and the taxation of affiliated corporations, of holding companies, and of financial institutions under current law. The Committee must report its recommendations to the 2003 General Assembly.
Section 6:	Provides that a taxpayer will not be subject to additional tax or to penalties for underpayment of a tax to the extent the underpayment was created or increased by Section 3 of S.L. 2001-327 if the taxpayer pays all tax due that was created or increased by Section 3 of S.L. 2001-327 within 15 days after the date this act became law, October 3, 2002.

Insurance Regulatory Fund Changes

Session Law	*Bill #*	*Sponsor*
S.L. 2002-144	**HB 1105**	**Representative Hurley**

AN ACT TO FUND THE OPERATIONS OF THE DEPARTMENT OF INSURANCE FOR THE FISCAL YEAR 2002-2003 THROUGH THE INSURANCE REGULATORY FUND BY EXPANDING THE PURPOSES FOR WHICH THE FUND MAY BE USED AND BY CREDITING VARIOUS FEES

COLLECTED BY THE DEPARTMENT AND OTHER AGENCIES UNDER THE DEPARTMENT INTO THE FUND FOR FISCAL YEAR 2002-2003, AND TO RESTORE THE 2002-2003 BUDGET REDUCTIONS SUSTAINED BY THE DEPARTMENT OF INSURANCE.

OVERVIEW: This act makes two changes relating to the Department of Insurance:

- It restores the $1.8 million budget cut the Department sustained for the 2002-2003 fiscal year in the Current Operations, Capital Improvements, and Finance Act of 2002. The increased appropriation from the General Fund will be reimbursed from the Insurance Regulatory Fund, which has a sufficient surplus.
- It provides that for the 2002-2003 fiscal year, certain fees collected by the Department of Insurance will no longer be retained as part of the Department's budget but will be credited to the Insurance Regulatory Fund and used to reimburse the General Fund for the Department of Insurance's expenses. The act was intended to appropriate to the Department for 2002-2003 the amount by which the fee changes reduce its budget, $3.2 million, but the appropriation was omitted by oversight. The Department is expected to receive these funds, however, through authorization from the legislative leadership.

FISCAL IMPACT: See Overview.

EFFECTIVE DATE: The act is effective for the 2002-2003 fiscal year only.

ANALYSIS: The two changes made by this act are not related, although both affect the Department of Insurance. Sections 9 and 10 of the act restore the $1.8 million budget cut the Department sustained for the 2002-2003 fiscal year in the Current Operations, Capital Improvements, and Finance Act of 2002. This restoration does not affect the General Fund. Although the Department of Insurance's budget is appropriated from the General Fund, the Insurance Regulatory Fund reimburses the General Fund for the appropriation. The additional $1.8 million is available as a surplus in the Insurance Regulatory Fund to reimburse the General Fund for the additional appropriation. Thus, neither the cut nor its restoration affected the General Fund.

The Department of Insurance regulates the insurance industry and other industries. Insurance companies pay an annual insurance regulatory charge that is measured as a percentage of each company's gross premiums tax. The proceeds of the charge are credited to the Insurance Regulatory Fund. Other industries regulated by the Department of Insurance also pay fees that are credited to the Insurance Regulatory Fund. The Fund is used to pay for the part of the Department's budget that goes to regulating the insurance industry and other industries. The funds are not paid to the Department of Insurance directly from the Insurance Regulatory Fund. Instead, the Department's budget is appropriated from the General Fund, and the Insurance Regulatory Fund reimburses the General Fund for the Department's costs of regulating the industries whose fees are credited to the Insurance Regulatory Fund.

In addition to regulating industries, the Department of Insurance has other functions relating to various State boards and commissions: the North Carolina Manufactured Housing Board, the State Fire and Rescue Commission, the Building Code Council, the North Carolina Code Officials Qualification Board, the Public Officers and Employees Liability Insurance commission, the North Carolina Home Inspector Licensure Board and the Volunteer Safety Workers Compensation Board. The Department's budget for these activities is supported by fees. The fees are collected and retained by the Department and used to cover these costs – there is no General Fund appropriation for these costs.

Sections 1 through 8 of this act change the way this part of the Department's budget is handled for the 2002-2003 fiscal year. Instead of retaining the fees, the Department of Insurance will deposit the fees in the Insurance Regulatory Fund. This eliminates the fee proceeds that would have been available to the Department to support these activities. The act was intended to appropriate additional funds from the General Fund to the Department of Insurance to support these activities. The additional appropriation would have been reimbursed to the General Fund from the Insurance Regulatory Fund, so there would have been no net fiscal impact, just an accounting change. Due to an oversight, the act failed to appropriate the additional funds to the Department of Insurance. The Department is expected to receive these funds, however, through authorization from the legislative leadership.

The act amends the Insurance Regulatory Fund statute to expand the purposes for which the Fund can be used for the 2002-2003 fiscal year, to cover not just regulating the insurance industry and other industries, but also carrying out other functions relating to boards and commissions. The insurance regulatory charge and the other fees paid into the Fund are not segregated from one another. Thus, a fee paid by one industry may end up being used for a function of the Department that relates to another industry. This pooling of the fees calls into question whether they can continue to be characterized legally as fees.

The issue of whether the insurance regulatory charge is a fee or a tax was raised in a recent case, *State Farm Mut. Auto. Ins. Co. v. Long*, 129 N.C.App. 164, 497 S.E.2d 451 (1998), aff'd 350 N.C. 84, 511 S.E.2d 303 (1999). In this case, the court evaluated the insurance regulatory charge under a three-part test used to distinguish a tax from a fee: (1) is it imposed by a legislative body or an administrative body; (2) is it imposed on a broad class or a narrow class of citizens; and (3) is it used for general public purposes, or used for the regulation or benefit of the parties upon whom the assessment is imposed. The court found that under the first two factors, the insurance regulatory charge could be either a fee or a tax. It held that the third factor was dispositive: the charge was a fee because it was credited to a segregated account and used only to regulate the insurance industry. Because this act broadens the purposes for which the charge may be used to include activities of the Department of Insurance that are not related to regulating the insurance industry, if the issue is raised in subsequent litigation, a court may find that the act changed the nature of the charge from a fee to a tax.

If the charge were ruled to be a tax rather than a fee, it would reduce the amount of revenue North Carolina receives as a result of the retaliatory premiums tax. The retaliatory premiums tax is imposed on foreign insurance companies doing business in North Carolina and is equal to the amount by which the NC premiums tax imposed on the company is less than the amount of premiums tax the company's home state would impose on an equivalent NC company doing business there. Because the insurance regulatory charge is considered a fee and not a tax, it is not added to the amount of NC tax used to calculate the retaliatory tax due. The lower the NC tax, the more retaliatory tax due.

Interstate Air Couriers – Bill Lee

Session Law	*Bill #*	*Sponsor*
S.L. 2002-146	**HB 1665**	**Representative Gray**

AN ACT TO AMEND TAX LAWS RELATED TO INTERSTATE AIR COURIERS AND TO AMEND THE WAGE STANDARD UNDER THE WILLIAM S. LEE QUALITY JOBS AND

BUSINESS EXPANSION ACT TO ACCOUNT FOR THE VALUE OF HEALTH INSURANCE TO PART-TIME JOBS.

OVERVIEW: This act rewrites the wage standard under the William S. Lee Quality Jobs and Business Expansion Act (hereinafter Bill Lee Act) to allow part-time jobs for which the taxpayer provides health insurance to be counted as having wages at least equal to the standard multiplied by the applicable average weekly wage for the county in which the jobs will be located. The act also makes the following changes to the Bill Lee Act as it applies to air courier hubs:

- Rewrites the definition of interstate air courier hub to conform to industry practice.
- Extends the Bill Lee Act sunset of January 1, 2006, to January 1, 2010, for an interstate air courier that enters into a major real estate lease on or before January 1, 2006, with an airport authority.
- Allows an interstate air courier that has, or is constructing, a hub in North Carolina to qualify for enhanced incentives if the courier makes an investment of $150 million or more within a seven-year period.
- Extends the sunset on the Piedmont Triad Airport Authority's exemption from the bidding laws from January 1, 2008, to January 1, 2010.

FISCAL IMPACT: The initial estimates of the impact of the Fed Ex incentives in 1998 have not changed with the delay in the project. The 1998 estimates indicated that the lower sales tax rate on handling and storage equipment would amount to $.4 million for the first two years that the project is getting started and $.1 million per year thereafter. The impact of the sales tax exemption for lubricants and repair parts comes into play after the facility is up and running. The estimate for this incentive is $.2 million a year. The uncertainty surrounding the timing of the project means that it is impossible to predict which year the impacts begin. Under current scheduling, the first year of the handling and storage equipment incentive could be 2005-06. The costs of the sales tax incentives will not occur until at least 2005-06.

In addition, the extension of the Bill Lee Act's sunset from 2006 to 2010 for interstate air couriers will allow Fed Ex and other eligible taxpayers to take tax credits under the Act during the 2006-09 period. Data from the State's 1998 offer of financial benefits to Fed Ex indicated that Bill Lee Act credits of $2 million would be taken over a four-year period.

EFFECTIVE DATE: The air courier hub definition rewrite became effective October 1, 2002, and applies to sales made on or after that date. The bidding law exemption effective date change became effective when the act became law, October 7, 2002. The remaining provisions in the act are effective for tax years beginning on or after January 1, 2002.

BACKGROUND: The Bill Lee Act was enacted in 1996, effective beginning with the 1996 tax year with a 2002 sunset. The Act is a package of State tax incentives and has been modified in each subsequent year. The incentives are primarily in the form of tax credits for investment in machinery and equipment and real property, for job creation, for worker training, and for research and development. Counties are divided into five economic distress tiers based on the unemployment rate, per capita income, and population growth of the county. For many of the credits, the lower the tier of a county, the more favorable the incentive. The Act requires the Department of Commerce and the Department of Revenue to report periodically on the credits allowed by the Act.

Before 1996, North Carolina had made little use of tax incentives to lure businesses to the State. Even without incentives, North Carolina was consistently one of the top states in attracting industry. The array of credits authorized by the Bill Lee Act was viewed as an experiment, to be evaluated in five years to determine whether the incentives were cost effective and actually affected behavior, or merely provided tax reductions to businesses that would have located or expanded in any case. In 1997, the General Assembly amended the Bill Lee Act to make interstate air couriers[48] an eligible business under the Act. In 1999, the General Assembly extended the 2002 sunset to 2006.

To be eligible for the credits under the Bill Lee Act, jobs must meet the applicable wage standard. There is no wage standard for jobs located in tiers one and two.[49] The wage standard for tiers three through five is 110% of the applicable average weekly wage for the county. For the credit for worker training or the credit for creating new jobs, the average wage of the jobs for which a credit is claimed and the average wage of all jobs at the location are required to meet the applicable wage standard. For the credit for investing in machinery and equipment, the credit for research and development, and the credit for investing in central office and aircraft facility property, the average wage of all jobs at the location with respect to which a credit is claimed are required to meet the applicable wage standard.

In 1998, the General Assembly provided sales tax and property tax reductions for interstate air couriers in order to encourage the development of air courier hubs in North Carolina. Effective January 1, 2001, sales to an interstate air courier of equipment for handling and storing materials at its hub became subject to a reduced sales tax of 1%, capped at $80 per item. In addition, interstate air couriers enjoy a sales tax exemption for purchases of aircraft lubricants, aircraft repair parts, and aircraft accessories for use at the air courier's hub in this State. Effective beginning with the 2001 property tax year, there is a property tax exemption for aircraft owned by an air courier and apportioned for property tax purposes to the courier's hub in this State.

ANALYSIS: Section 1 of this act amends the definition of "hub" for interstate air couriers and recodifies the definition of "interstate air couriers" for sales tax purposes. The amendment to the definition of "hub" was needed because the prior definition did not accurately describe hubs. The prior definition stated, in part, that a hub is the airport in the State where the air courier has allocated at least 60% of its aircraft value apportioned to this State. Aircraft value is apportioned based on revenues generated and on the amount of time the aircraft is on the ground. In the case of air couriers, revenue is generated at the customer site, not at the hub. Additionally, aircraft spend very little time on the ground at the hub. For these two reasons, the definition of an air courier hub formerly in the statutes did not fit the factual situation. This act defines a hub as the primary airport in the State for sorting and distributing packages from which the air courier has, or expects to have, at least 150 departures a month. This definition is similar to the definition of "hub" under South Carolina law, but is a more stringent test as South Carolina requires only 25 departures a month.

The definition of "interstate air courier" is not substantively amended. Currently, for sales tax purposes, the definition of interstate air courier refers to the definition used in the Bill Lee Act. In this act, the definition of "interstate air courier" for sales tax purposes is made a stand-alone definition. There is no substantive change to the definition.

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[48] An air courier is an air carrier that delivers individually addressed letters, parcels, and packages. Examples of air couriers include UPS and Federal Express.

[49] S.L. 2002-172 eliminated the wage standard in tiers one and two.

Section 2 of this act extends the sunset date on the Bill Lee Act until January 1, 2010, for certain interstate air couriers and Sections 4 through 7 of the act increase various time frames in the act from two years to seven years. The interstate air courier industry, and the construction of a hub in particular, face many regulatory, administrative, and legal hurdles not generally faced by other industries. Due to these extra burdens, time frames in this industry are generally longer than in other industries. There is generally a longer period between the time that a project is announced and a location is selected and the time the facility is placed in service. Due to these longer time frames, it was argued that an extension of the sunset and extensions of various time frames are needed to accommodate these projects.

Section 3 of this act amends the wage standards under the Bill Lee Act for all taxpayers. Currently, in order to be eligible for any of the credits under the Bill Lee Act, the average wage of all jobs at the location must meet or exceed the wage standard for the county in which the jobs are located.[50] Included in this calculation are part-time jobs, converted to a full-time equivalency. Some interested parties argued that because part-time jobs are not eligible for a credit for job creation, they should not be considered in this calculation. The inclusion of part-time jobs can disqualify a project since part-time jobs generally pay less than full-time jobs.

This act takes a middle ground. All part-time jobs must still be considered when the wage calculation is made. However, any part-time job for which the taxpayer provides health insurance will be considered to have a wage that at least meets the applicable average weekly wage. If a part-time job with health insurance has a wage that is less than the applicable average weekly wage, the applicable average weekly wage will be used in making the calculation. If a part-time job with health insurance has a wage that is greater than the applicable average weekly wage, the actual wage of the job will be used in making the calculation.

Section 8 of this act provides an extension of the bidding law exemption for the Piedmont Triad Airport Authority. When the General Assembly enacted certain tax incentives for interstate air couriers in 1998, one provision of that act granted a bidding law exemption for the Piedmont Triad Airport Authority. The exemption became effective beginning January 1, 1999, and applies to design and construction of an air freight distribution facility on airport property, and related supplies, equipment, and services. S.L. 2001-476 (Senate Bill 748) provided an extension of this exemption from January 1, 2004, to January 1, 2008. Upon the request of Fed Ex, this act extends the exemption to January 1, 2010. With this extension, the bidding law exemption would sunset at the same time as the Bill Lee Act for certain interstate air couriers.

Amend Property Tax Laws

Session Law	*Bill #*	*Sponsor*
S.L. 2002-156	**HB 1523**	**Representative Hill**

AN ACT TO AMEND VARIOUS PROPERTY TAX LAWS.

[50] As mentioned above, for the credits for job creation and for worker training, the average wage of the particular jobs for which the credit is claimed must also meet or exceed the applicable average weekly wage.

OVERVIEW: This act is a recommendation of the Revenue Laws Study Committee based on proposals by the North Carolina Association of Assessing Officers and the Department of Revenue. It makes the following changes to the property tax law:

- Increases the minimum penalty for a worthless check from $1 to $25 and provides that the tax collector may waive or reduce the penalty. This change became affective when the act became law, October 9, 2002.
- Provides a uniform procedure for appeals regarding taxation of personal property and authorizes the board of equalization and review to meet year round to hear these appeals. These changes are effective beginning with the 2003 property tax year.
- Delays from 2002 until 2003 the effective date of a 2001 law that defined certain single-section manufactured homes as real property for tax purposes.
- Adds an additional collection assistance fee of $15 to debts owed to local governments and collected by the Department of Revenue through tax refund setoff, effective January 1, 2003. The fee will be used to pay local governments' costs of submitting debts for collection by setoff.

FISCAL IMPACT: Two provisions of the act are likely to have a fiscal impact. Increasing the minimum charge for a returned check will likely increase local fee revenues. However, granting the assessor the authority to waive the fee will offset some of the increase. The exact amount of this revenue change is unknown. The second potential impact relates to the debt setoff program. The act will reduce the cost of debt collection for local governments and will likely increase program usage. However, no firm estimate is available on the total financial impact for local governments.

EFFECTIVE DATE: See Overview.

ANALYSIS: This act makes a number of changes to the property tax laws. First, it modifies the penalty for giving a worthless check. It increases the minimum penalty from $1 to $25. The penalty is 10% of the amount of the check, subject to the minimum and to a maximum of $1,000. It also authorizes the tax collector to waive the worthless check penalty. Tax collectors do not have the general authority to waive property tax penalties. By comparison, the Secretary of Revenue has general authority to waive tax penalties.

Second, the act provides a uniform procedure and timetable for appeals relating to personal property, effective beginning with the 2003 property tax year. Under prior law, the statutes specified the procedure and timetable for real property appeals but not for personal property appeals; as a result, different counties had adopted different procedures and timetables. This act provides a uniform system: the taxpayer may appeal value, situs, or taxability within 30 days after receiving notice of value. The notice must inform the taxpayer of the 30-day period. The assessor is required to respond to each appeal and the taxpayer has 30 days to appeal the assessor's final decision to the board of equalization and review or the board of county commissioners. The act authorizes boards of equalization and review to sit year-round to hear personal property appeals. In 2001, the General Assembly authorized boards of equalization in review to sit year-round to hear appeals relating to discovered property, motor vehicle taxation, and annual audits of whether property qualifies for special tax treatment.

Third, the act delays from 2002 to 2003 the effective date of 2001 legislation that changed the way manufactured homes are classified for property tax purposes. A manufactured home is defined in G.S. 143-143.9 as:

> A structure, transportable in one or more sections, which, in the traveling mode, is eight feet or more in width or is 40 feet or more in length, or when erected on site, is 320 or more square feet, and which is built on a permanent chassis and designed to be used as a dwelling with or without a permanent foundation when connected to the required utilities, and includes the plumbing, heating, air conditioning and electrical systems contained therein.

Since 1987, North Carolina law had provided that a manufactured home was considered real property for property tax purposes if it (i) consisted of two or more sections; (ii) had its hitch, wheels, and axles removed; and (iii) was placed upon a permanent foundation on land owned by the owner of the manufactured home. In 2001, the General Assembly removed the requirement that the home consist of two or more sections, effective beginning with the 2002 tax year. After the 2001 act became law, county assessors realized they would not have time to review all the manufactured homes in each county to determine which ones should be reclassified as real property for the 2002 tax year. The assessors had requested an extension until the 2004 tax year, but this act delays the change only until the 2003 tax year.

Fourth, the act imposes an additional collection assistance fee of $15 on debts owed to local governments and collected by the Department of Revenue through tax refund setoff. Under the Setoff Debt Collection Act, the Department of Revenue diverts the income tax refund of an individual who owes money to a State or local agency to pay the debt owed to that agency. The debt the individual owes the agency is set off against the individual's income tax refund. Under existing law, a collection assistance fee of no more than $15 is imposed on debts (other than child support debts) collected by setoff, to reimburse the State for its costs of operating the setoff debt collection program. This act adds an additional collection fee of $15 for debts (other than child support debts) owed to local governments and collected by setoff, effective January 1, 2003. The Department of Revenue will collect the fee as part of the setoff process and remit the fee to the clearinghouse that submits local debts on behalf of local governments. The purpose of the fee is to recover the cost to local governments of submitting debts for collection by setoff. The clearinghouse that submits debts on behalf of local governments was created through a joint agreement between cities and counties; the local governments have also contracted with a third party to process and compile local debts for setoff.

GUARANTEED ENERGY SAVINGS CONTRACTS

Session Law	*Bill #*	*Sponsor*
S.L. 2002-161	**HB 623**	**Representative McMahan**

AN ACT TO PROMOTE ENERGY EFFICIENCY IN STATE-OWNED BUILDINGS.

OVERVIEW: Authorized the State to enter into up to $50 million of installment finance contracts to finance guaranteed energy savings measures. Under prior law, only local governments had the authority to enter into these contracts.

ANALYSIS: Since 1994, local governments have had the authority to enter into financing contracts to finance the cost of energy conservation measures. This authority is in Part 2 of Article 3B of G.S. Chapter 143. An energy conservation measure is an alteration, training, or services that will provide anticipated energy savings with respect to a facility. The financing contracts are known as guaranteed energy savings contracts. Under the contract to implement energy conservation measures, all payments, except obligations on early termination, are to be made

over time and energy cost savings are guaranteed to exceed the cost of the contract. Local governments use installment purchase contracts to finance these expenditures. The authority for this type of local government debt is found generally in G.S. 160A-20 and, specifically with respect to guaranteed energy savings contracts, in G.S. 143-64.17C. The law provides that a guaranteed energy savings contract is not a pledge of the government's taxing power.

This act extended to State agencies the authority to enter into guaranteed energy savings contracts. The act provides that the State will use generally the same procedures for soliciting the contracts that apply to local governments under current law. The State Energy Office of the Department of Administration is required to adopt rules for agencies to follow in evaluating the contracts, subject to approval by the State Treasurer. State agencies that enter into guaranteed energy savings contracts are required to report to the State Energy Office which in turn reports annually to the Joint Legislative Commission on Governmental Operations. The act clarifies that State energy conservation measures are subject to inspection and compliance.

Unlike local governments, State agencies do not have general authority to enter into debt in the form of installment purchase contracts. For this reason, Section 9 of the act added a new Article to Chapter 142 of the General Statutes providing the authority for State agencies to incur this type of debt. The aggregate principal amount payable by the State under these contracts is limited to $50 million. The debt is secured by a lien on or a security interest in any part of the property with respect to which an energy conservation measure is undertaken and/or the land upon which the property is or will be located.

There is no pledge of the State's faith and credit or taxing power. Thus, voter approval is not necessary for the borrowing. If the State defaulted on its repayments, no deficiency judgment could be rendered against the State, but the property that serves as security could be disposed of to generate funds to satisfy the debt. The State could choose not to appropriate funds to repay the debt, but such a decision would have negative consequences for the State's credit rating.

Under the act, the funds can be borrowed from the vendor with whom the agency contracts, or can be borrowed through the sale of certificates of participation (COPs). In a typical COPs transaction, a State-controlled nonprofit corporation acts as a straw person for the purpose of entering into the installment purchase contract with the State. The nonprofit corporation then raises capital for the energy conservation measure being purchased by the State by assigning or participating out its rights to receive the installment payments to be made by the State pursuant to the contract. COPs are certificates that evidence that assignment of the rights to receive these installment payments; and it is through the sale of COPs to investors that capital is raised to acquire or construct the item being financed.

Before a guaranteed energy savings contract can be entered into, the Office of State Budget and Management must certify that resources are expected to be available to pay the amounts due under the contract. Next, the Council of State must approve the contract by resolution that sets out the maximum maturity, and the maximum interest rates. The maximum maturity may not exceed 12 years. The State Treasurer also must approve the financing, finding that the amount to be borrowed is adequate and not excessive and will not require an excessive increase in any State revenues to provide for repayment, and that the special indebtedness can be incurred or issued on terms favorable to the State.

NC Economic Stimulus and Job Creation Act

Session Law	*Bill #*	*Sponsor*
S.L. 2002-172	**HB 1734**	**Representative Owens**

AN ACT TO ESTABLISH AND MODIFY VARIOUS ECONOMIC INCENTIVE PROGRAMS FOR BUSINESS AND INDUSTRY; TO AMEND PROVISIONS RELATING TO INDUSTRIAL AND POLLUTION CONTROL FACILITIES FINANCING; TO AUTHORIZE PLANNING AND DEVELOPMENT FOR A BIOPHARMACEUTICAL TRAINING CENTER AND A CANCER REHABILITATION TREATMENT CENTER; AND TO MAKE TECHNICAL AND CONFORMING CHANGES.

OVERVIEW: There are six parts to this act. Part 1 of this act amends the Bill Lee Act by scaling back the credit for machinery and equipment in tiers three, four, and five, by eliminating the wage standard in tiers one and two and in development zones, and by eliminating the wage standard for the credit for worker training. Part 2 of the act creates the Jobs Development Investment Grant Program, a discretionary program that awards grants to businesses based on a percentage of employee withholdings over a number of years. Part 3 of the act requires production companies to spend at least $1 million in North Carolina to be eligible for a grant from the Film Industry Development Account. Part 4 of the act makes a technical change to the North Carolina Railroad's condemnation authority. Part 5 of the act eases the public hearing requirements for Industrial Development Bonds to facilitate bonds for smaller manufacturers. Part 6 of the act provides authorization to initiate planning and development of a new biopharmaceutical training center and a cancer rehabilitation treatment center.

FISCAL IMPACT: The Bill Lee Act changes will generate approximately $3.45 million for fiscal year 2003-04, $7 million for fiscal year 2004-05, and $10.56 million for fiscal year 2005-06. No fiscal impact is expected from the changes to the film industry incentives. The Jobs Development Investment Grant Program represents a significant change from the structure of the Bill Lee Act incentives. It is impossible to determine the exact dollar cost of the Program. However, the Program is limited to 15 projects per year and $10 million in grants per year, and it sunsets on January 1, 2005. Thus the maximum grant amount that may be awarded during the 13 years the Program is in effect is $240 million.

EFFECTIVE DATE: See Analysis.

ANALYSIS: There are six main components to this act: changes to the William S. Lee Quality Jobs and Business Expansion Act (hereinafter Bill Lee Act)[51], the establishment of a new economic development grant program for new and expanding businesses, changes to film industry incentives, changes to the condemnation authority of a railroad company, changes to industrial and pollution control facilities financing law, and authorization to initiate planning and development of a new biopharmaceutical training center and a cancer rehabilitation treatment center.

Part 1. Bill Lee Act: Part 1 makes the following substantive changes to the Bill Lee Act:

Machinery and Equipment. A taxpayer is allowed a credit for the cost of machinery and equipment placed into service during a taxable year that exceeds the applicable threshold based on the location where the machinery and equipment are placed into service. Under prior law, the amount of the credit was equal to 7% of the cost of the machinery and equipment in

[51] For background on the Bill Lee Act, see the summary for S.L. 2002-146.

excess of the applicable threshold. Section 1.1 of this act makes two changes to this credit. First, the amount of the credit is reduced in enterprise tiers three, four, and five. In those areas, the amount of the credit is reduced to 6%, 5%, and 4%, respectively, of the cost of the machinery and equipment in excess of the applicable threshold. Second, the amount of the threshold is increased in enterprise tiers four and five. In enterprise tier four, the threshold is increased from $500,000 to $1,000,000. In enterprise tier five, the threshold is increased from $1,000,000 to $2,000,000. This section is effective for taxable years beginning on or after January 1, 2003, and applies to business activities that occur on or after that date, but does not apply to business activities that occur on or after January 1, 2003, that are subject to a letter of commitment signed before January 1, 2003.

Overdue Tax Debts. If the Secretary of Revenue discovers that any tax is due from a taxpayer, the Secretary must notify the taxpayer in writing of the Secretary's intent to assess the taxpayer for the tax. The notice must describe the basis for the assessment, the amount of tax to be assessed and any interest and penalties due. If the taxpayer disagrees with the assessment, the taxpayer has 30 days to request a hearing before the Secretary. The Secretary must then schedule a hearing to occur within 90 days of the request. Within 90 days after the hearing, the Secretary must issue a decision on the hearing. If the taxpayer does not request a hearing within the 30 days allowed, or if the Secretary finds that the tax is due after the hearing, the proposed assessment becomes a final assessment. If a taxpayer disagrees with a final assessment, the taxpayer may appeal the decision to the Tax Review Board, and then on to superior court, the Court of Appeals, and the Supreme Court. A tax debt is a final assessment after all possibilities for appeal have been exhausted. An overdue tax debt is any part of a tax remaining after 90 days. Section 1.2 would make a taxpayer ineligible for a credit under the Bill Lee Act if the taxpayer had any overdue tax debts. Section 1.5 defines an overdue tax debt. These two sections are effective for taxable years beginning on or after January 1, 2003.

Wage Standard. A taxpayer is eligible for a credit under the Bill Lee Act only if the jobs provided by the taxpayer meet a wage standard. Under prior law, the wage standard was 110% (100% in an enterprise tier one area or a development zone) of the applicable average weekly wage. The jobs that are included in calculating the wage standard vary depending on the particular credit.

Section 1.3 of this act makes three substantive changes to the wage standard. The changes are effective for taxable years beginning on or after January 1, 2003. First, this section eliminates the wage standard in enterprise tier one and two areas. Since the wage standard for a business located in a development zone is the same as for tier one counties, this section also eliminates the wage standard for a development zone area.

Second, this section eliminates the wage standard for the credit for worker training. In order to be eligible for the credit for worker training, the employee who is being retrained must either (i) occupy a job for which the taxpayer is eligible to claim a credit for creating jobs, or (ii) be trained to operate machinery and equipment for which a taxpayer is eligible to claim a credit for investing in machinery and equipment. Thus, the jobs for which the credit for worker training may be claimed have already been included in a larger group of jobs that has met the wage standard. Often the specific jobs for which worker training is required are lower-paying jobs that could not themselves meet the wage standard. This change allows the credit for worker training to be taken by more taxpayers.

Third, this section makes an allowance for a taxpayer that has a taxable year other than a calendar year. To perform the wage standard test, the taxpayer compares the average weekly wage of certain jobs to the wage standard determined on an annual basis. The test is performed

for the calendar year that jobs are created or for which worker training is provided. However, performing a wage standard test based on a calendar year is not feasible because many companies have taxable years that do not coincide with the calendar year. Consequently, the taxpayer can engage in activity that qualifies for a credit during a taxable year that spans two calendar years. If the taxpayer creates jobs in different calendar years, it must compute the combined average weekly wage of the jobs created during its taxable year and compare this average to the county wage standard to determine if it qualifies for a tax credit. It cannot, however, compute this average "for the calendar year the jobs are created" as required by the prior law because the jobs are created over the course of two calendar years. Under this act, the wage standard test is based on the taxpayer's taxable year and not the calendar year. When a taxable year spans two calendar years, the applicable wage standard is that of the earlier calendar year. In addition to correcting a practical problem, this change generally will be favorable for taxpayers because county wage standards generally trend upward.

Development Zones. In 1998, the General Assembly amended the Bill Lee Act to provide additional incentives for businesses that locate or expand in development zones, which are economically distressed areas located within cities. The statutory conditions for qualifying as a development zone are designed to target only these relatively small, economically distressed areas.

A development zone is defined as an area that meets all of the following conditions: (1) it consists of one or more contiguous census tracts, block groups, or both, (2) it has a population of 1,000 or more, at least 20% of whom are below the poverty level, (3) it is located at least partly in a city with a population over 5,000, (4) every census tract and census block group in the zone is located in whole or in part within the primary corporate limits of the city, (5) every census tract and census block group in the zone has more than 10% of its population below the poverty level, or is immediately adjacent to a tract or group that has more than 20% of its population below the poverty level, and (6) none of the census tracts or census block groups is located in another development zone.

This act expands this definition of development zone to include all of a parcel of land that is located partially within the zone if all of the following conditions are met:

- At least 50% of the parcel is located within the zone.
- The parcel was in existence and under common ownership prior to the previous decennial federal census.
- The parcel is a portion of land made up of one or more tracts or tax parcels of land that is surrounded by a continuous perimeter boundary.

The following enhanced incentives apply in development zones: If a business locates in a development zone, its maximum worker training credit is $1,000 rather than $500, it receives an additional $4,000 per job on its jobs tax credit, and the credit for investing in machinery and equipment is calculated as if the zone were in a tier one county. In addition, a business located in a development zone does not have to meet a wage standard to be eligible for the credits. This section is effective for taxable years beginning on or after January 1, 2003.

Part 2. Job Development Investment Grant Program. Part 2 of this act creates a new economic development tool for new and expanding businesses in North Carolina. This tool would be used to attract businesses to the State by allowing a five-member committee to award grants to businesses. The amount of the grants would be based on income tax withholdings from new jobs created by the businesses. This part became effective October 31, 2002.

Which projects are eligible for a grant? In order to be eligible for a grant under this program, the business must create a minimum number of new jobs. The number of new jobs that must be created varies based on the enterprise tier designation of the location where the jobs will be located. For projects located in enterprise tiers one through three, the project must create at least 10 new full-time positions. For projects located in enterprise tiers four and five, the project must create at least 20 new full-time positions. If a project is located in more than one location, the enterprise tier designation of the location in the highest enterprise tier area determines the number of new jobs that must be created.

As with the Bill Lee Act, a business must provide health insurance for all full-time jobs associated with the project in order to be eligible for this new program. The test is the same as under the Bill Lee Act – the business must, for all full-time employees of the project, pay at least 50% of the premiums for health insurance that meets at least the minimum provisions of the basic health care plan of coverage recommended by the Small Employer Carrier Committee. In addition, the average wage of all jobs at the location with respect to which a grant is sought must meet the Bill Lee wage standard, as amended by this act. Finally, as with the Bill Lee Act, the business must have no citations under the Occupational Safety and Health Act that have become a final order within the previous three years for willful serious violations or for failing to abate serious violations with respect to the location for which the grant is made.

Unlike under the Bill Lee Act, there are few restrictions based on the industry in which the business is engaged. There are only two types of projects that are ineligible for consideration under this program: retail facilities and professional and semiprofessional sports teams and clubs.

More generally, the project must satisfy the following conditions in order to be eligible for a grant:

- The project will result in net new employment in the State by the business.
- The project will benefit the people of the State by increasing employment opportunities and strengthening the State's economy.
- The project is consistent with economic development goals for the State.
- A grant is needed in order to secure the project for the State.
- The total benefits of the project to the State outweigh the costs associated with the project.

How a grant is obtained? In order to obtain a grant under this program, the business must apply to the Economic Investment Committee for consideration. The Economic Investment Committee is a five-member committee consisting of the Secretary of Commerce, the Secretary of Revenue, the Director of the Office of State Budget and Management, one member appointed by the General Assembly upon the recommendation of the Speaker of the House of Representatives, and one member appointed by the General Assembly upon the recommendation of the President Pro Tempore of the Senate[52]. The members appointed by the General Assembly serve two-year terms. The Committee may act only upon a decision of at least three of its five members. The Committee is subject to the open meetings law and the public records law. Members of the Committee are forbidden to work for a business that receives a grant under this program for at least two years after the member is no longer on the Committee.

[52] The members of the Committee appointed by the General Assembly may not be members of the General Assembly.

A former member of the Committee who violates this prohibition against working for a business that receives a grant under this program must forfeit any compensation received for that work and is prohibited for an additional two years from working for a business that receives a grant under this program.

The application for a grant must be under oath, be on a form prescribed by the Committee, and contain any information required by the Committee. At a minimum, the application must contain the following information:

- The name of the business, the proposed location of the project, and the type of activity in which the business will engage at the project site.
- The names and addresses of the principals or management of the business, and the nature of the business, and the form of business organization under which the business is operated.
- The financial statements of the business prepared by a certified public accountant.
- The number of new jobs proposed to be created by the project.
- An estimate of the withholdings of personal income tax of employees of the project.
- Information concerning other possible locations of the project, and the benefits, including tax benefits or grants, associated with locating the project at that other location.
- Information concerning other State grants for which the business is applying or that it expects to receive.
- Certification that the project will provide health insurance to all full-time employees.

A group of related businesses involved in a project may submit a joint application for a grant under this program.

Any application for a grant must be accompanied by a fee in the amount of $5,000. This fee will be allocated by the Secretary of Commerce, the Secretary of Revenue, and the Director of the Office of State Budget and Management among their agencies.

The Committee will evaluate applications to determine which businesses will receive grants under this program. The awarding of a grant is solely in the discretion of the Committee. The Committee is required to develop criteria for evaluating applications. These criteria must take into consideration the economic impact of the project; the strategic importance of the project to the State, region, or locality; the quality of the jobs to be created; the quality of the industry and the project; the environmental impact of the project; and the degree to which the use of the program has been geographically dispersed throughout the State.

The Committee is required to be somewhat selective in choosing projects to receive a grant. The Committee may not enter into more than 15 agreements in any calendar year. However, there may be significantly more than 15 agreements outstanding at any time because the term of an agreement may be as long as 12 years. In addition, the Committee may not commit more than $10 million dollars annually with agreements entered into in any calendar year[53].

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[53] The total annual commitment may be much more than $10 million dollars. For example, agreements entered into during each of the 2003 and 2004 calendar years could each make commitments of up to $10 million annually, for a total annual commitment of up to $20 million.

How is the amount of a grant determined? If the Committee approves a business's application, the Committee will then negotiate and enter into a community economic development agreement with the business. The agreement is a binding commitment on the part of the State to provide the grant for a set number of years, subject to the Committee's right or duty to amend or terminate the agreement under certain circumstances. Each agreement must include a description of the project, the term of the agreement, the number of positions expected to be subject to the grant and a method for determining the number of positions that are subject to the grant, and the amount of the grant as a percentage of the withholdings of personal income tax from eligible positions. The Committee has wide discretion in setting the percentage that determines the amount of a grant under an agreement. The Committee must develop criteria to be used when negotiating the appropriate percentage. At a minimum, the following conditions apply:

- The amount of the grant may not be less than ten percent (10%) or more than seventy-five percent (75%) of the withholdings associated with new jobs at the project.
- The term of the grant cannot exceed 12 years.
- The percentage used to determine the amount of the grant must be reduced by one-fourth for any eligible position located in an enterprise tier four or five area.
- Unless the Committee makes a specific determination that the grant should be calculated based on eligible positions created in additional years during the term of the agreement, the amount of the grant is calculated based only on eligible positions created during the base years (the first two years) of the agreement.
- Unless the Committee makes an explicit finding otherwise, the total amount of all grants provided by the State may not exceed seventy-five (75%) of the withholding of eligible positions.
- The amount of a grant associated with any specific position may not exceed $6,500 in a year.

In addition, the Committee must consider at least the following factors when negotiating a percentage to be used in determining the amount of a grant:

- The number of eligible positions to be created.
- The expected duration of those positions.
- The type of contribution the business can make to the long-term growth of the State's economy.
- The amount of other financial assistance the project will receive from the State or local governments.
- The total dollar investment the business is making in the project.
- Whether the project utilizes existing infrastructure.
- Whether the project is located in a development zone.
- The number of eligible positions that will be filled by residents of a development zone.
- The extent to which the project will mitigate unemployment in the State and locality.

Use of funds? There are no restrictions on the use of the grant fund by the business. South Carolina has a similar grant program. Under the South Carolina program, grant funds may be used for certain specific purposes only, such as worker training, worker relocation, purchase or construction of real property, and construction or repairs to certain transportation-related real property.

The withholdings retained by the State would be used in two different ways. First, the withholdings in excess of the percentage negotiated in the agreement would flow to the General Fund.[54] Second, the withholdings that are included in the agreement, but that are excluded from the grant because the percentage was reduced by one-fourth because the eligible position is located in an enterprise tier four or five area, would be transferred to the Utility Account of the Industrial Development Fund. [55] Funds in the Utility Account may be used to assist local governments in tiers one, two, and three in constructing or improving utility lines or equipment, including telecommunications and high-speed, broadband lines and equipment.[56]

Terms of agreement. The Committee has a great deal of flexibility in negotiating agreements. However, the legislation does require the agreements to include certain provisions, such as information on the new jobs created and a method to verify the positions, reporting requirements, and the reasons for which an agreement may be amended or terminated and the benefits recaptured. In addition, the Attorney General must review the terms of all proposed agreements and must personally sign each agreement.

Follow-up on grantee businesses. This act provides for monitoring of grantee businesses in several ways and requires the Committee to amend or terminate agreements if the business fails to live up to the terms of the agreement or the requirements of this new program.

The business must submit annual reports to the Committee. In addition, the Committee may audit at any time a business receiving a grant. At a minimum, the business must submit a copy of its federal and State income tax returns which show business and nonbusiness income, a report that shows withholdings, and a payroll report. This annual submission must also include any additional information the Committee considers necessary to implement the grant program.

This annual submission must be accompanied by a fee of $1,500. The Committee shall allocate the fee among the agencies responsible for evaluating the submission.

The Committee must also obtain information from the Department of Revenue before the disbursement of a grant. The Department of Revenue must certify the amount of withholdings from the eligible business.

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[54] Even though the maximum percentage that may be used to determine the amount of a grant is 75%, there may be no additional revenue from these positions that would flow to the General Fund. This is because most taxpayers over-withhold, meaning that more taxes are withheld than are actually due, resulting in a refund to the taxpayer. Because of this, a grant based on the maximum percentage of 75% could result in a net loss to the General Fund.

[55] The following example will clarify this. Assume a project that is located in an enterprise tier five area is allowed a grant based on 75% of the withholdings of the eligible positions. Because those positions are located in an enterprise tier five area, that percentage is reduced by one-fourth, so that the business is allowed a grant equal to 56.25% of the withholdings of eligible positions. (75% multiplied by ¾ equals 56.25%.) Twenty-five percent of the withholdings of eligible positions would flow to the General Fund, 56.25% would be given to the business in the form of a grant, and 18.75% would be transferred to the Utility Account of the Industrial Development Fund.

[56] Part 2 of this act amended the law regarding the Industrial Development Fund and the Utility Account.

The Committee is required to amend or terminate the agreement and to recapture all or part of a grant made in previous years under certain circumstances. If the business fails to meet or comply with any term of the agreement or with criteria developed by the Committee, the Committee must amend the agreement and may terminate the agreement. This amendment may take the form of a lower percentage being used to determine the amount of the grant or of a shorter term for the agreement. The reduction must be proportional to the failure to comply with the agreement. If the business fails to meet or comply with any term of the agreement or with criteria developed by the Committee for two consecutive years, the Committee must terminate the agreement. In addition, the Committee must include a provision in each agreement describing the conditions that will lead to recapture of a grant made in an earlier year.

As with the Bill Lee Act, as amended by this act, a business that has an overdue tax debt is penalized. A business that has an overdue tax debt may not receive an annual disbursement of a grant so long as that overdue tax debt is not satisfied or otherwise resolved.

Program evaluation. The act requires the Committee to report quarterly and annually.[57] The annual report must include information on the agreements entered into during the year as well as an update on the status of projects for which an agreement was entered into in the past. Additionally, the reports must provide information on the number of jobs created and the tax benefit derived from those positions, the types of jobs created, and the geographic distribution of the grants.

The authority of the Committee to enter into additional agreements begins as of January 1, 2003, and expires as of January 1, 2005. This sunset will allow the General Assembly an opportunity to review the program after it has been in effect for a few years in order to determine if the program is meeting its objectives.

Miscellaneous changes associated with the program. Section 2.2 of this act makes two significant changes to the Industrial Development Fund and to the Utility Account, which is part of that Fund. The Industrial Development Fund provides assistance to local governments for improvements to infrastructure to enable the locality to attract new businesses. Usually, this assistance is provided to make general improvements, such as improvements to or development of industrial parks, and is not tied to luring a specific project.

First, the purposes for which funds in both the Fund and the Account may be used are expanded to allow expenditures for telecommunications and high-speed broadband lines and equipment. Currently, funds under both the Fund and the Account may be used for construction of and improvements to water, sewer, gas, and electricity lines and equipment. This change recognizes the growing importance to industry of telecommunications and high-speed broadband.

Second, under current law, funds in the Utility Account may be used to assist local governments located in enterprise tiers one and two only. This act would expand the focus of the Account to allow funds in the Account to be used to assist local governments in enterprise tier three as well.

Section 2.3 allows an exemption from the confidentiality requirements of the Department of Revenue. Generally, the Department of Revenue must keep confidential all information it receives in the course of administering the tax laws. There are numerous, specific exceptions to this requirement. This act would allow the Department of Revenue to share information with the Economic Investment Committee relating to businesses that are applying for a grant or that are subject to an agreement.

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[57] The Committee must report by April 30th of each year.

Section 2.4 of this act corrects a statutory reference in two laws dealing with the purposes for which a local government may levy a property tax.

Section 2.5 prohibits a member of the General Assembly from serving on the Economic Investment Committee. Under the constitutional doctrine of separation of powers, legislators cannot serve on executive boards exercising executive functions.

Section 2.6 of this act exempts the Economic Investment Committee from the rule-making process under the Administrative Procedure Act. However, Section 2.1, in G.S. 143B-437.48(d) as enacted by this act, requires the Committee to publish the proposed criteria on the Department of Commerce's web site at least 15 business days prior to the adoption of or an amendment to any proposed criteria. The Committee must also provide notice to persons who have requested notice of proposed criteria and it must accept oral and written comments on the proposed criteria.

Section 2.7 of this act requires the Revenue Laws Study Committee to study the use, the effectiveness, and the cost versus benefit of the Job Development Investment Grant Program, the Bill Lee Act, and the Industrial Recruitment Competitive Fund. Given that the Job Development Investment Grant Program is just starting up, the time frame for the study is longer than usual. Revenue Laws may report to the 2004 Regular Session of the General Assembly and a final report is due by March 15, 2005, to the 2005 General Assembly.

Part 3. Film Industry Incentives. Part 3 of this act amends the Film Industry Development Account to require a minimum expenditure in North Carolina before a project may be eligible for a grant from the Account. The Film Industry Development Account was established in 2000 with the intent of providing economic incentives to production companies for operations in North Carolina. Under the account, a production company is eligible for a grant based on expenditures made in the State. The grant may not exceed fifteen percent of those expenditures. The grant is not available for political or issue advertising or for any production that is considered obscene under G.S. 14-190.1. The amount of the grant may not exceed $200,000. This section adds an additional requirement that the production company have expenditures of at least $1 million in the State. This more narrowly targets this incentive to large productions.

Section 3.2 directs the Revenue Laws Study Committee to study other incentives for the film industry and to report to the 2003 General Assembly. This part became effective October 31, 2002.

Part 4. North Carolina Railroad Condemnation Authority. Part 4 of this act makes a technical correction to the condemnation authority of a railroad. In 1998, State responsibility for railroad regulation was moved from the Utilities Commission to the Department of Transportation. At that time, G.S. 62-232 was repealed. This section deletes a cross-reference to that statute. This does not appear to have any substantive effect on the power of a railroad to condemn property. This part became effective October 31, 2002.

Part 5. Industrial and Pollution Control Facilities Financing. The Department of Commerce hopes to reinstate a program begun in the late 1980's that would permit small companies to take advantage of industrial development bond financing by grouping several small loans into a single bond issue. In order to make that program workable, the process needs to be as streamlined as much as possible. As currently written, bonds issued under Article 1 of Chapter 159D (for industrial projects) require a public hearing at the local level - that is, by the county commissioners of the county in which the facility will be located. In addition, for those bonds the federal tax exemption rules require a hearing at the state level by the agency, with

the result that there would be two public hearings. Bonds issued under Article 2 of Chapter 159D (which are special purpose projects and educational facilities) require a public hearing by the North Carolina Capital Facilities Finance Agency (NCCFFA), with notice to the governing bodies of the localities in which the facilities will be located.

Part 5 of this act modifies Article 1 of Chapter 159D so that the public hearing for a bond issue dealing with multiple projects would take place at a location determined by the NCCFFA – most likely at its headquarters in Raleigh. This change simply removes the requirement of multiple public hearings throughout the State for one bond issue. The local government would still have to approve the project in its jurisdiction under a different section of the statute. This change would not affect bond issues involving a single project.

This part also makes a conforming change to Article 1 of Chapter 159D. In both Chapter 159C (relating to industrial development bonds through local authorities) and Chapter 159D, Article 2 (relating to special purpose projects and educational facilities) the Local Government Commission is permitted to take into consideration credit enhancement when determining whether a project is feasible. That language was omitted from Article 1 of Chapter 159D. There appears to be no reason to treat an industrial development project differently when it comes through a local authority rather than the NCCFFA. Part 5 of this act becomes effective January 1, 2003.

Part 6. Capital Planning Costs for Biopharmaceutical Training Center and Cancer Rehabilitation Treatment Center. Part 6 of the act authorizes the initial planning and development of two capital projects, effective October 31, 2002. It authorizes the State Board of Community Colleges, the Board of Governors of the University of North Carolina, and the North Carolina Biotechnology Center to initiate planning and development of a new biopharmaceutical/bioprocess manufacturing training center to be centrally located and of related training facilities to be located at various community colleges. The State has invested greatly through the North Carolina Biotechnology Center to bring close to 150 biotechnology companies to the State over the past 15 years. The biopharmaceutical and bioprocessing industry anticipates the need for 3,000 to 5,000 new employees each year for the foreseeable future. These workers will require training and education at a variety of levels in biotechnology, bioprocessing, and biomanufacturing. An Alliance Council, representing the universities, community colleges, and biomanufacturing companies, will develop a comprehensive training and education program capable of training 3,000 to 5,000 people for the industry annually through a combination of large-scale equipment training and academic programs at a Central Training Center and programs at the Regional Training Centers.

It also authorizes the Board of Directors of the University of North Carolina Health Care System to initiate planning and development of a new cancer rehabilitation and treatment center to be located at the University of North Carolina Hospitals at Chapel Hill. The UNC Health Care System provides services for patients with cancer in the Gravely Building, a building that opened in 1953 as a tuberculosis sanitarium. This nearly 50-year-old facility has been remodeled to its fullest extent, and can no longer meet the needs of modern-day programs and services required to treat patients with cancer. The Gravely Building is also inadequate for the support of UNC's clinical research mission for clinical trials and for testing new medications that are essential for enhancing treatment options and increasing the knowledge base for new treatment opportunities. The UNC Health Care System proposes a replacement to the North Carolina Clinical Cancer Center to address these deficiencies and to provide a more appropriate environment for patients with cancer.

Amend Use Value Statutes and Other Tax Laws

Session Law	*Bill #*	*Sponsor*
S.L. 2002-184	**SB 1161**	**Senator Hartsell**

AN ACT TO AMEND THE PRESENT-USE VALUE STATUTES, TO CREATE A PROPERTY TAX SUBCOMMITTEE OF THE REVENUE LAWS STUDY COMMITTEE, TO CLARIFY THE SALES AND USE TAX EXEMPTION REGARDING CERTAIN AGRICULTURAL SUBSTANCES, AND TO MAKE VARIOUS ADMINISTRATIVE CHANGES IN THE TAX LAWS.

OVERVIEW: Sections 1 through 7 of this act amend the present-use value law to provide an updated method for calculating the value of farmland in its present use, to clarify the sound management requirement for qualifying for use value taxation, to allow land subject to a conservation easement to continue to qualify for use value taxation, and to make numerous clarifying and procedural changes. Most of the changes to the use value law were recommended by the Revenue Laws Study Committee.

Section 8 of the act establishes a property tax subcommittee of the Revenue Laws Study Committee.

Sections 9 through 12 of the act make changes to the administration of various sales tax laws. These changes were recommended by the Revenue Laws Study Committee.

FISCAL IMPACT: The provision related to the sales taxes on plant inhibitor equipment is likely to create a small but undefined revenue gain. The change in sales tax payment dates will result in a small revenue loss due to the loss of the float, but no exact estimate is possible. The use value changes will affect local governments, but data are not available to calculate the amount of the impact. The remaining items will all result in a slight but undefined loss or no loss to the General Fund.

EFFECTIVE DATE: The changes to the present-use value law are effective beginning with the 2003 property tax year. The remaining changes became effective in October 2002.

ANALYSIS:

Use Value Changes. This act provides for more accurate determination of the present use value of farmland. Since 1973, the General Assembly has provided that farmland (agricultural land, horticultural land, and forestland) may be appraised, assessed, and taxed at its present-use value, as opposed to its fair market value. The present-use value classification helps preserve farmland by insulating it from the rising property tax values caused by competing market pressures to develop farmland for commercial and residential purposes.

The difference between the taxes due based on the present use value and the taxes that would have been payable based on market value, together with any interest, penalties, or costs, are a lien on the property. This difference in taxes is carried forward in the records of the taxing unit as deferred taxes. The deferred taxes for the preceding three years become payable whenever the property loses its eligibility for the benefit of the special use value law.

In 1985, the General Assembly enacted the most recent methodology for calculating present-use value: The value was required to be based on capitalization of net income at the rate of 9%; for agricultural land, the net income was to be based on average corn and soybean yields. The Department of Revenue was required to prepare and distribute annually to each tax assessor a present-use value manual to assist in appraising and assessing farmland. A

four-member Use-Value Advisory Board, under the supervision of the Agricultural Extension Service of North Carolina State University, would submit a recommended manual to the Department each year. The present-use value manual is advisory only, and each county remains free to develop its own present-use value schedules. Until several years ago, all counties used the manual. By 2002, an increasing number of counties were not using the manual because the present-use values in the manual could not be supported by credible market evidence. For example, corn and soybeans, which are used to determine net income for agricultural land, no longer represent the typical crops grown in the State and are not the major money crops. Using a method that did not result in realistic values was eroding the intent to foster uniformity and creating equity problems between similar types of properties.

This act updates the method of determining the present-use value of farmland in several ways. First, it changes the capitalization rate used to capitalize net income into value for agricultural and horticultural land. Instead of 9%, the rate to be used will be set by the Use-Value Advisory Board at a level between 6% and 7%. The Board will also recommend annually to the General Assembly whether this range should be changed. The capitalization rate for forestland will stay at 9%.

Second, the act changes the method the Board will use to set the net income for farmland. Instead of corn and soybean yields for agricultural land and horticultural product yields for horticultural land, the Board is required to use estimated cash rental rates for various classes of soil or for geographic areas. The Department of Revenue is given the responsibility of conducting studies of cash rents for agricultural land on a regional basis and providing this information to the Board. For forestland, the Board is required to use ranges furnished by the NC Cooperative Extension Service based on up to six classes of land within each region designated by the federal Soil Conservation Service. This requirement reflects the current practice of the Board with respect to forestland.

Third, the act caps the value the Board may establish for the best agricultural land at a maximum of $1,200 per acre. The Board will recommend annually to the General Assembly whether this maximum should be changed.

Fourth, the act adds five new members to the Use-Value Advisory Board. Under existing law, there were four members: The director of the Agricultural Extension Service at NCSU, a Department of Agriculture representative, a Forest Resources Division representative, and a representative of the Agricultural Extensions Service at N.C.A.&T. This act adds the director of the Property Tax Division of the Department of Revenue and one representative of each of the following four groups: the Farm Bureau, the Association of Assessing Officers, the Association of County Commissioners, and the Forestry Association.

To qualify for use value taxation, farmland must be in active commercial production under a sound management program, which is defined as a program of production designed to obtain the greatest net return from the land consistent with its conservation and long-term improvement. The act makes two changes relating to sound management. First, it provides that woodland that is part of agricultural or horticultural land is not required to be under a sound management program if it meets either of the following conditions:

1. It is less than 20 acres.
2. Its best use is as a barrier to wind erosion, a natural water purifier, or a buffer for hog or poultry operations.

Second, it specifies factors any one of which is sufficient to demonstrate that farmland is under a sound management program. For agricultural or horticultural land, these factors include compliance with an agency-administered management program, with a set of best management practices, or a minimum gross income test; evidence of net income from farming or that farming is the operator's principal source of income; and certification by a recognized local agency. For forestland, compliance with a written sound forest management plan for production and sale of forest products is sufficient.

In order to qualify for use value taxation, in addition to being in active production, the land must meet minimum income requirements and must satisfy certain conditions regarding ownership. This act creates an exception to these requirements and conditions for property that was being taxed at its present use value as farmland and then becomes subject to a conservation easement that dedicates it for conservation purposes in the hands of the State, a local government, or a nonprofit conservation organization.

The remaining changes the act makes relating to use value are procedural and technical.

County assessors are required to annually review 1/8 of the county's use value parcels to verify that they continue to qualify for use value taxation. This act clarifies that the 1/8 is a minimum – an assessor may review more than 1/8 in a year. This act also authorizes the assessor to request assistance in carrying out the review, clarifies the information that the assessor may require the owner to submit and the information that the assessor must consider as part of the review, and clarifies that the review is based on data for a three-year period. In addition, this act authorizes the county to assign county agencies or contract with federal agencies for any duties relating to use value accounts.

In order to qualify for use value taxation, the farmland must be owned by certain qualifying individuals, family business entities, or trusts. This act clarifies that the farmland may qualify if it is owned jointly by any of these owners as tenants in common. The act also clarifies an exception to the ownership requirements. Individual owners must live on the land or have owned the land in their family for four years. There is an exception if use value land is transferred to a person who continues to use it as farmland and meets the other conditions for use value treatment. This act clarifies that the deferred taxes that accrued while the land was owned by the first owner continue as a lien on the property in the hands of the new owner. In addition, the new owner must file an application for use value treatment within 60 days after acquiring the land, certifying that the present use will continue and that the new owner will be liable for the deferred taxes if the land is later disqualified. The act makes technical and conforming changes relating to the application for use value treatment.

To qualify for use value treatment, farmland must be part of a farm unit. This act defines the term "unit" to include one or more tracts under common ownership. If the tracts are in separate counties, they must share the same type of classification or the same equipment or labor force, and must be within 50 miles of a tract that meets the minimum size and income requirements for use value treatment.

Property Tax Subcommittee. Section 8 of the act creates a property tax subcommittee of the Revenue Laws Study Committee. The subcommittee will have six members and will study use value taxation and existing and potential tax incentives for farm use, conservation, and environmental protection of land.

Administrative Changes. The remaining sections of this act are administrative changes to the sales tax law. These changes were originally introduced in House Bill 1509 as a recommendation of the Revenue Laws Study Committee.

Section 9 of the act clarifies the sales and use tax exemption for certain agricultural substances. Included among the agricultural group of sales and use tax exemptions is an exemption for plant growth inhibitors, regulators, or stimulators when purchased for use on plants held or produced for commercial purposes. In a recent case, *American Ripener Company, Inc. v. Secretary of Revenue,*[58] the court ruled that the exemption for these substances could extend to generators used to control the release of the substance. The Department requested that the statute be clarified because the exemption was not intended to include any hardware or machinery, such as generators, used to apply the exempted substances. Section 9 clarifies that the exemption does not apply to any equipment or devices used to dispense the substances listed in the exemption.

Section 10 of this act changes the due date for quarterly sales tax returns from the 15th of a month to the end of a month. In 2001, the General Assembly lowered the threshold for monthly payments of withheld taxes from $500 to $250. Monthly withholding returns are due on the 15th of the month, the same day as monthly and quarterly sales and use tax returns. The withholding tax threshold change moved approximately 25,000 employers from a quarterly to a monthly filing status. As a result, the Department was receiving 25,000 additional returns in eight of the twelve months of the year. This act's change of the sales tax due date from the 15th to the end of the month will enable the Department to spread its work more evenly throughout the month. As of 2002, there were 91,000 quarterly sales tax filers. The change also makes the due date for quarterly sales tax returns consistent with the due date for quarterly withholding tax returns. This change went into effect October 1, 2002; it does not affect the timing of local sales and use tax distributions, nor does it shift any funds from one fiscal year to the next.

Section 11 of the act amends the method for calculating the underpayment penalty for semimonthly sales taxpayers, to conform to the requirements of the Streamlined Sales Tax Project. A taxpayer who is consistently liable for at least $10,000 a month in State and local sales and use taxes must pay the tax twice a month and file a return on a monthly basis. A payment is required for each semimonthly period. The first semimonthly payment covers the period from the first day of the month through the 15th day of the month, and the second semimonthly payment covers the period from the 16th day of the month through the last day of the month. The monthly return covers both semimonthly payment periods including any additional amount due and must be filed by the 20th day of the following month. Under prior law, a taxpayer was not subject to interest or penalties for an underpayment for a semimonthly payment period if the taxpayer timely paid at least 95% of the amount due for that payment period and included the underpayment with the monthly return for both payment periods.

A requirement of the Streamlined Sales Tax Project, in which North Carolina has participated since 2000, is that if the State requires more than one remittance per return, the amount of the additional remittance must be determined through a calculation method rather than actual collections. Effective October 1, 2002, Section 11 brings the underpayment penalty calculation for semimonthly sales taxpayers in line with the Project by providing an additional method of calculating the estimated tax liability: neither interest nor penalties will apply to the underpayment of sales tax remitted on a semimonthly basis if the taxpayer timely pays at least 95% of the lesser of (i) the amount due for the semimonthly payment period; or (ii) the average semimonthly payment for the prior calendar year. Just as under the prior law, the taxpayer

[58] 147 N.C. App. 142 (2001), cert. denied, 355 N.C. 210 (2002)

must also include the underpayment with the monthly return for those semimonthly payment periods.

Section 12 of the act codifies a longstanding practice of the Department of Revenue which requires that a purchaser of tangible personal property that is exempt from sales tax or subject to a preferential rate of sales tax must obtain an exemption certificate from the Department in order to receive the exemption or preferential rate. The Department of Revenue administers many of the sales and use tax exemptions and preferential rates targeted at certain industries, such as farming and manufacturing, through the use of an exemption certificate. Prior to this change, the statutes did not address exemption certificates, except in the penalty provisions in G.S. 105-236(5a), which authorize the Secretary to assess a penalty for the misuse of an exemption certificate. The Department recommended that the practice of using exemption certificates be incorporated into the statutes to avoid any questions about the ability of taxpayers to claim exemptions through this method.

Securities Fraud Protections & Study

Session Law	*Bill #*	*Sponsor*
S.L. 2002-189	**SB 1455**	**Senator Rand**

AN ACT TO AUTHORIZE THE GENERAL STATUTES COMMISSION AND OTHER INTERESTED PARTIES TO STUDY THE PROVISIONS OF SENATE BILL 1455, 4TH EDITION, STRENGTHEN SECURITIES FRAUD ENFORCEMENT LAWS, INTRODUCED IN THE 2001 GENERAL ASSEMBLY, AND TO MAKE RECOMMENDATIONS TO THE 2003 REGULAR SESSION OF THE 2003 GENERAL ASSEMBLY; TO INCREASE CERTAIN FILING AND RENEWAL FEES WITH THE SECRETARY OF STATE; TO FUND ADDITIONAL SECURITIES INVESTIGATOR POSITIONS; TO PROHIBIT THE STATE FROM CONTRACTING WITH BUSINESSES THAT HAVE ANY OFFICERS OR DIRECTORS WHO HAVE BEEN CONVICTED OF SECURITIES FRAUD; TO PROHIBIT THE STATE FROM CONTRACTING WITH VENDORS THAT ARE INCORPORATED IN A TAX HAVEN COUNTRY BUT THE UNITED STATES IS THE PRINCIPAL MARKET FOR THE PUBLIC TRADING OF THEIR CORPORATION'S STOCK; AND TO AUTHORIZE THE STATE TREASURER, IN CONSULTATION WITH THE SECRETARY OF STATE, AND THE LEGISLATIVE RESEARCH COMMISSION TO STUDY THE CREATION OF A PENSION ASSURANCE FUND TO PROTECT THE RETIREMENT SAVINGS AND INVESTMENTS OF THE CITIZENS OF NORTH CAROLINA.

Section 6 of the act prohibits the Secretary of Administration from entering into a contract with a vendor or an affiliate of a vendor if the vendor or affiliate is incorporated in a tax haven country after December 31, 2001, but the United States is the principal market for the public trading of the corporation's stock. The vendor is required to certify, upon submitting a bid or contract, that it does not violate the provisions of this section. The definition of "tax haven country" is identical to the definition of the same term found in federal legislation currently before Congress that would prohibit the federal government from using defense-spending funds as payment on any new contracts with "corporate expatriates."

2001

Retirement Home Tax Change

Session Law	*Bill #*	*Sponsor*
S.L. 2001-17	**HB 193**	**Representative Jarrell**

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

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

FISCAL IMPACT: There is no fiscal impact on the General Fund. Estimates based on the best information available suggest this act could result in a loss of county revenues of $1.7 million to $2.5 million. Fiscal Research believes the actual cost of the exemptions could be higher. As a result, the range listed is actually a minimum estimate.

EFFECTIVE DATE: Effective for taxes imposed for taxable years beginning on or after July 1, 2001. In addition, an application for the benefit provided in this act for the 2001-2002 tax year is timely if it is filed on or before September 1, 2001.

ANALYSIS: Under G.S. 105-278.6, property owned by a nonprofit home for the aged, sick, or infirm is exempt from property tax if used for a charitable purpose. A charitable purpose is defined as "one that has humane and philanthropic objectives; it is an activity that benefits humanity or a significant rather than limited segment of the community without expectation of pecuniary profit or reward." From 1999 to 2001, G.S. 105-278.6A allowed an additional property tax exclusion to certain nonprofit CCRCs that did not meet the definition of "charitable purpose", but did meet all of the following conditions:

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

This property tax exclusion for CCRCs expired on July 1, 2001.

This act creates a permanent, complete or partial exclusion for CCRCs that provide minimum amounts of charity care and/or community benefits. First, this act modifies the language describing the property that is eligible for the exclusion. This was done to conform this description to the language in the statutes allowing property tax exemptions for property used for religious purposes, for educational purposes, and for religious educational purposes. This provision exempts the buildings, the land they actually occupy, and additional land reasonably necessary for the convenient use of these buildings if the buildings and land meet the conditions for eligibility described below.

Second, this act adds several new definitions to the statute. The new definitions define charity care, community benefits, financial reporting period, resident revenue, and unreimbursed costs.

Third, this act amends the current definition of "retirement facility" in two ways. It deletes the condition that the facility's grounds and buildings be at a single site. This change will allow a CCRC to expand without requiring the purchase of contiguous land. In addition, it requires that the facility be licensed as a continuing care retirement community by the Department of Insurance. A licensed facility must provide a contract for continuing care that sets out provisions such as the total consideration to be paid and the services to be provided. The licensed facility must also give each prospective resident a detailed disclosure statement, and must maintain operating reserves equal to 50% of the total operating costs projected for the 12-month period following the period covered by the most recent annual statement filed with the Department of Insurance. G.S. 58-64-1 defines "continuing care" as "the furnishing to an individual other than an individual related by blood, marriage, or adoption to the person furnishing the care, of lodging together with nursing services, medical services, or other health related services, under an agreement effective for the life of the individual or for a period longer than one year."

Fourth, the act allows a total property tax exclusion for a retirement facility that satisfies each of the following conditions:

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

Fifth, the act allows a partial property tax exclusion for a retirement facility that satisfies each of the following conditions:

- It meets the new definition of a retirement facility.
- It meets the current conditions of a retirement facility, except that the facility's governing board does not have to be selected by a charitable nonprofit that is exempt under 501(c)(3) of the Code.

- It provides at least 1% of its resident revenue for the financial reporting period in charity care to its residents, in community benefits, or in both.

The partial exclusion in based on a sliding scale. The exclusion is equal to 80% of the assessed value if the facility provides a minimum of 4% of the facility's resident revenue in charity care and community benefits. The amount of the exclusion decreases by 20 percentage points for each percentage point decrease in resident revenue used to provide charity care and community benefits. The minimum partial exclusion is 20% of the assessed value if the facility provides a minimum of 1% of the facility's resident revenue in charity care and community benefits.

Sixth, this act clarifies that the owner of the facility must file annually for the property tax exclusion as required by G.S. 105-282.1. The application must contain the facts that entitle the owner to the exclusion.

Lease-Purchase up to Three Prisons

Session Law #	*Bill #*	*Sponsor*
S.L. 2001-84	**SB 25**	**Senator Jordan**

AN ACT TO CLARIFY THE STATE'S AUTHORITY TO LEASE-PURCHASE THREE CLOSE SECURITY CORRECTIONAL FACILITIES.

OVERVIEW: This act clarifies the procedure and financing for the State's authority to lease-purchase up to three close security correctional facilities. The initial construction loan for the prison must be obtained by the vendor on a private, taxable basis, and the State's acquisition of the constructed prisons will be financed with tax-exempt obligations. The act will save the State millions of dollars by clarifying the authorization of tax-exempt financing.

FISCAL IMPACT: The overall fiscal impact of the act is expected to be as follows:

	FY 2001-02	*FY 2002-03*	*FY 2003-04*	*FY 2004-05*	*FY 2005-06*
General Fund Revenues*	0	0	$800,000 to $2,981,250	0	0
General Fund Expenditures	0	0	$2,008,700 to $6,010,200	$6,236,980 to $18,664,538	$6,237,827 to $18,663,007

*Revenues are investment earnings from the unspent "bond" proceeds in the year of issuance. (certificates of participation). Expenditures are based on the price range of leasing one to three prisons, and a 5.3% interest rate at the time the certificates of participation are issued (assuming a September 1, 2003 issuance date). The actual interest rate will affect fiscal impact.

EFFECTIVE DATE: This act became effective May 17, 2001.

BACKGROUND: In Section 18.20.(a) of S.L. 1999-237, the General Assembly enacted G.S. 148-37(b1) authorizing the Department of Correction to contract with private firms for the construction of prisons totaling up to 3000 cells, to be operated by the State under a lease with

a schedule for purchase of the prisons over a period of up to 20 years.[1] The Department of Correction was required to consult with legislative leaders before entering into a contract. This 1999 legislation, effective July 1, intended that the State construction requirements, such as the multiple prime contractors rule, would not apply because the construction would be financed by private parties. It also intended that the State would begin leasing the prisons only after they had been completed, approved, and accepted.

The question of whether the prisons could be financed tax-exempt did not arise until after the 1999 legislation was enacted. The Department of Correction issued a request for proposals (RFP) requiring that the financing must not involve the State's credit (and thus must be taxable), consistent with an interpretation by the Attorney General's Office. After the RFP was issued, it was determined that the State could save millions of dollars if the prisons were financed on a tax-exempt basis. The Justice and Public Safety Subcommittee of the Joint Legislative Commission on Governmental Operations recommended that a new RFP be issued in accordance with proposed legislation to authorize tax-exempt financing.

ANALYSIS: This act clarifies that the initial construction loan must be obtained by the vendor on a private, taxable basis, and that the State's acquisition of the constructed prisons will be financed with tax-exempt obligations. The act provides that after the prisons are completed, approved, and accepted by the State, a nonprofit corporation controlled by the State would purchase the prisons from the vendor and lease them to the State under a lease-purchase agreement. The nonprofit corporation would finance its purchase price for the prisons by selling tax-exempt obligations known as certificates of participation (COPs). The COPs represent interests in the nonprofit corporation's rights to receive the lease payments under the lease-purchase agreement with the State. The COPs are secured by a lien on the property, not by a pledge of the State's full faith and credit. The COPs are paid from the State's lease-purchase payments over the course of 20 years.

In January 2001, the Department of Correction issued a new RFP consistent with the financing arrangement clarified in this act. The RFP anticipated that vendors would provide separate bids for one, two, or three 1000-bed facilities. The bill had to be enacted in order for the contract to be awarded. The deadline for vendors to submit proposals was April 10, 2001, and three proposals were received. The Department of Correction was required to consult with the Joint Legislative Commission on Governmental Operations before making a final award decision. The final award decision was also subject to the approval of the Council of State.[2]

Under the plan of finance clarified in the act, there are separate contracts for construction, purchase, and lease-purchase of the prisons. The construction contract is between the vendor and the State. It requires the vendor to obtain its own construction financing, which must be derived solely from private funds. Because only private funds would be involved during the construction phase, and because the vendor is at risk for that construction financing until the completed facilities are delivered, requirements for public bidding of construction do not apply. While the facilities are being constructed, title will be in the vendor. The facilities will not be subject to local property taxes during this stage, however, because Section 15.(a) of S.L. 2001-427 enacted an exemption for correctional facilities being constructed on State land. The

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[1] Projections of prison population by the Sentencing and Policy Advisory Commission indicate population will exceed prison bed capacity by 2002 and could exceed capacity by at least 3000 beds in 2005, without additional prison beds or changes in prison population.

[2] S.L. 2001-424 (SB 1005) and S.L. 2001-322 (SB 34) authorized the Department of Correction to contract for three prisons if approved by the Council of State. Approvals were received and construction began on two of the prisons in November 2001.

prisons are required to be built in accordance with plans and specifications developed by the Department of Correction, and the Department of Correction and the State Construction Office will inspect and review the facilities during construction to ensure that they are suitable for use and acquisition by the State.

The purchase agreement will be between the vendor and the State-created nonprofit corporation that will sell the tax-exempt COPs. The nonprofit corporation that sells the COPs is subject to the Public Records Act and the Open Meeting Laws. The purchase will take place only after the facilities are completed and accepted by the State. It is expected that the construction period will last two or two and one-half years. After the nonprofit corporation purchases the facilities, they remain exempt from local property taxes. The nonprofit corporation pays for the purchase with funds derived from the sale of the COPs. It is expected that the COPs will be sold close to the time of purchase, although the State may have the nonprofit corporation sell the COPs earlier if the State Treasurer determines that an earlier sale is to the advantage of the State. Even if the COPs are sold earlier, there will be no payments from the State's General Fund until after the prisons have been accepted and purchased. Because of the State's involvement, interest with respect to the COPs is tax-exempt.

The lease-purchase agreement is between the nonprofit corporation and the State. Under the agreement, which must be approved by the Council of State and the State Treasurer, the State will make lease-purchase payments to the nonprofit corporation, which will use the funds to retire the COPs. The COPs will be secured by a lien on the property and the State's failure to make payments could result in its eviction from the property. The State Treasurer determines the price to be paid for the COPs and the rate of interest to be paid on them. The State will retain the option of refinancing the debt if interest rates fall. The State also retains the option of paying off its obligations and purchasing the property before the end of the lease-purchase period. Under the lease-purchase agreement, the State will own the facilities at the end of the lease term.

Extend Tax Deadline

Session Law	*Bill #*	*Sponsor*
S.L. 2001-87	**HB 150**	**Representative Allen**

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

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

FISCAL IMPACT: There is no fiscal impact because the act conforms State law to the actual administrative practice of the Department of Revenue.

EFFECTIVE DATE: The act became effective on May 17, 2001.

ANALYSIS: This act adds a new subsection to G.S. 105-249.2 that prohibits the Secretary from assessing any penalties for failure to obtain a business license, failure to file a return, or failure to pay taxes if the license, return, or taxes are due during the time federal tax-related deadlines are extended because of a Presidentially declared disaster. The taxpayer residing

or having a business in the affected area is still liable for interest that accrues from the original due date until the date the tax is paid. This proposal codifies the Department of Revenue's current published penalty policy: the occurrence of a disaster is an automatic reason to waive penalties.

BACKGROUND:

Existing State Law

G.S. 105-237 authorizes the Secretary to waive or reduce any penalty. It is the policy of the Department of Revenue that the occurrence of a disaster is an automatic reason to waive penalties, but such a waiver was not previously required under North Carolina law.

In certain specific circumstances penalties must be waived. G.S. 105-249.2 provides that the Secretary of Revenue may not assess a penalty or interest against a taxpayer during any period that federal tax deadlines are postponed under the Code because of the taxpayer's service in a combat zone or the taxpayer's hospitalization because of injuries received while serving in a combat zone. The taxpayer is also granted an extension of time to file a return or take another action concerning a State tax during this period. A key distinction between this provision and the provision regarding Presidentially declared disasters is that this provision also prohibits the Secretary from assessing interest against a taxpayer[3].

In addition, G.S. 105-263 authorizes the Secretary to extend the time to file a report or return with the Secretary. An extension for filing a franchise tax return, income tax return, or gift tax return does not extend the time for paying the tax due or the time when a penalty attaches. An extension for filing a report or any other return does extend the time for paying the tax due and the time when a penalty attaches. When an extension for filing a report or return extends the time for paying the tax expected to be due, interest accrues on the tax due from the original due date of the report or return to the date the tax is paid. This provision differs from the provision regarding Presidentially declared disasters in that it does not prohibit the assessment of penalties related to filing a franchise tax return, an income tax return, or a gift tax return.

Existing Federal Law

Section 7508A of the Code authorizes the Secretary of the Treasury to prescribe regulations to postpone certain deadlines for up to 120 days[4] for a taxpayer affected by a Presidentially declared disaster area.[5] A "Presidentially declared disaster area" means any disaster which, with respect to the area in which the property is located, resulted in a subsequent determination by the President that the area warrants assistance by the Federal Government under the Disaster Relief and Emergency Assistance Act. Deadlines that may be postponed are the same as ones postponed because of service in a combat zone. They include the deadlines for all of the following:

- Filing of any return of income, estate, or gift tax (except for employment or withholding taxes).
- Payment of any income, estate, or gift tax (except employment or withholding taxes).

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[3] This distinction is also made in the corresponding provisions in the Code, Sections 7508 and 7508A.

[4] As of January 1, 2001, the reference date for the Code, deadlines could be postponed for up to 90 days, rather than 120 days, for a taxpayer affected by a Presidentially declared disaster.

[5] Postponement does not apply to the determination of interest on any overpayment or underpayment. However, §6404(h) of the Code requires the IRS to abate the assessment of interest in Presidentially declared disaster areas if the time for filing an income tax return and paying income tax is extended.

- Filing of a Tax Court petition for redetermination of a deficiency or review of Tax Court decision.
- Allowance of a credit or refund.
- Filing of a claim for credit or refund.
- Bringing of any suit on the claim for credit or refund.
- Assessment of any tax.
- The giving or making of any notice or demand for payment of any tax or with respect to any liability to the United States in respect of any tax.
- The collection by levy or otherwise of any tax liability.
- The bringing of a suit by the U.S. with respect to any tax liability.
- Any other act required or permitted under the related regulations.

Previous disaster responses

After Hurricanes Fran and Floyd, the Department issued press releases granting an extension for tax-related deadlines. The extension allowed after Fran was in conformity with the extension granted by the IRS. However the extension allowed after Floyd was not as long as the IRS extension. After Floyd the State granted an extension to December 15, while the IRS extended the time for returns and payments and for enforcement activities to January 31. This discrepancy resulted in some taxpayers filing their State returns and making payments on the January 31 IRS extension date. These taxpayers were subject to additional interest and penalties. These penalties were waived if the taxpayer notified the Department.

Property Tax Amendments

Session Law #	*Bill #*	*Sponsor*
S.L. 2001-139	**SB 162**	**Senator Hartsell**

AN ACT TO AMEND VARIOUS PROPERTY TAX LAWS.

OVERVIEW: This act is a recommendation of the Revenue Laws Study Committee. It makes the following changes to the property tax laws recommended to the Committee by the Department of Revenue, the Institute of Government, and the Association of Assessing Officers:

- It clarifies the application process for property tax exemptions and exclusions.
- It gives the assessor the authority to remove a property's preferential tax classification if the taxpayer does not provide the assessor with the information requested to verify the property's qualifications for the preferential tax classification. It provides that an owner has 60 days, rather than 30 days, to respond to the assessor's request for information. It also provides that any deferred taxes that were paid as a result of a revocation of present-use value status must be refunded to the taxpayer once the taxpayer has responded to the assessor's request for information unless the information discloses that the property no longer qualifies for the classification.

- It gives all boards of equalization and review the authority to meet after its adjournment date to hear cases related to use value, exempt property, discoveries, and motor vehicle valuation.
- It clarifies the changes allowed in a non-reappraisal year.
- It shortens the waiting period for in rem foreclosures.
- It conforms the interest rate on unpaid motor vehicle taxes to the interest rate due on other unpaid property taxes.

FISCAL IMPACT: The act's fiscal impact is expected to be minimal. Most provisions will have no impact. The use value, interest rate, and preferential tax treatment removal provisions could create a small revenue gain for local governments. However, because the primary effect of these sections of the act will be to prod taxpayers to act, no noticeable revenue increase is expected. The ability to change valuations in a non-revaluation year could result in a positive or negative revenue impact, depending on the changes made to the property and its use.

EFFECTIVE DATE: The part of the act that clarifies the changes allowed in a non-appraisal year becomes effective for taxes imposed for taxable years beginning on or after July 1, 2002. The part of the act that shortens the waiting period for in rem foreclosure proceedings became effective July 1, 2001, and applies to in rem foreclosure proceedings begun on or after that date. The part of the act that conforms the interest rate on unpaid motor vehicle taxes with other unpaid property taxes became effective for taxes imposed for taxable years beginning on or after July 1, 2001. The remainder of this act became effective on May 31, 2001.

ANALYSIS: The act makes the following changes to the property tax laws:

Exemption and Exclusion Application Provisions (Section 1)

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

Clarify Changes Allowed in a Non-revaluation Year (Section 2)

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

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

Annual Review of Property with Preferential Tax Treatment (Sections 3, and 4)

Under existing law, the assessor must annually review 1/8 of the properties exempt or excluded from taxation to verify that they continue to qualify for their exemption or exclusion. Likewise, the assessor must annually review 1/8 of the properties classified for present-use value to verify that they qualify for the preferential tax value. The law requires the owner to provide the information requested by the assessor to determine the property's qualifications for the exemption or exclusion. However, the law does not penalize the taxpayer if the taxpayer fails to comply with the request. The act provides a consequence if the owner fails to give the requested information to the assessor. If the owner does not without good cause provide the information within 60 days from the date of the assessor's written request, the owner loses the preferential tax classification.

Annual Review of Transportation Maps (Section 5)

The act requires the assessor to annually review the transportation corridor official maps and amendments to them. These properties are currently taxed at 20% of the general tax rate. Under prior law, a taxpayer had to apply for this preferential tax rate. However, under the act, the preferential tax rate will attach to the property automatically (See Section 1). To ensure proper oversight of the preferential classification, the act also provides that the assessor must annually review the transportation corridor official maps.

Allow E&R Board to Meet After Adjournment to Hear Use Value, Exempt Property, Discoveries, and Motor Vehicle Cases (Sections 6 and 7)

The act provides that a county board of equalization and review may meet after its adjournment date to hear appeals relating to motor vehicle property taxes, discoveries, and property reviewed annually to determine its continued qualification for exemption or exclusion. Cabarrus, Lincoln, and Stokes Counties already have this authority under local acts.

Interest Rate on Unpaid Motor Vehicle Taxes (Section 8)

The act conforms the interest rate due on unpaid motor vehicle taxes to the interest rate due on other unpaid property taxes: 2% for the first month following the date the taxes were due and ¾% for each month thereafter. Under prior law, the amount of interest due on unpaid motor vehicle taxes was ¾% per month. This amount was not enough to encourage people to pay their tax in a timely manner.

Shorten Waiting Period of In Rem Foreclosures (Section 9)

The act shortens the waiting period of in rem foreclosures from six month to three months. Prior law allowed a property tax judgment to be executed at any time after six months and before two years from the indexing of the judgment. This change allows the judgment to be acted upon within three months of the date the judgment is indexed.

Various Motor Fuel Tax Changes

Session Law #	*Bill #*	*Sponsor*

S.L. 2001-205	SB 967	Senator Kerr

AN ACT TO MAKE TECHNICAL AND ADMINISTRATIVE CHANGES TO THE MOTOR FUELS TAX LAW.

OVERVIEW: This act clarifies information sharing, provides a procedure for fuel tax refunds using third party credit cards, modifies refunds for kerosene used for certain non-highway purposes, and makes technical changes to the motor fuel tax laws, as requested by the Department of Revenue.

FISCAL IMPACT: No estimate available. The acceleration of kerosene tax refunds will produce a minor loss of interest revenue to the Highway Fund/Highway Trust Fund, and a corresponding minor gain of interest for the General Fund because of sales tax paid on exempt motor fuels.

EFFECTIVE DATE: This act became effective October 1, 2001, except for the section allowing the sharing of information, which became effective June 18, 2001.

ANALYSIS: First, the act makes an exception to the tax secrecy law to allow the Department of Revenue to provide identifying information about motor carriers whose licenses have been revoked. The information can be provided only to the administrator of a national criminal justice system that serves as an information clearinghouse for use only by criminal justice agencies and public safety organizations. The Department of Revenue currently participates in such a system, the State On-Line Enforcement Network (STOLEN). Sharing information about motor carriers whose licenses have been revoked will promote cooperative efforts under the International Fuel Tax Agreement (IFTA), an agreement between member taxing jurisdictions to assist each other in the collection and administration of taxes paid by interstate motor carriers on their use of motor fuel. Under the IFTA, a motor carrier declares one member jurisdiction to be the carrier's base jurisdiction for registering the carrier's vehicles for purposes of the road taxes and reporting the taxes due to all the member jurisdictions. The base jurisdiction then collects the road taxes payable by the motor carrier to every member jurisdiction and remits the taxes collected to the appropriate jurisdictions. By centralizing the payment and collection of road taxes, the IFTA greatly simplifies the payment of road taxes by motor carriers and the collection of road taxes by the member jurisdictions.

Second, the act establishes a procedure for administering tax refunds on fuel sold to an exempt entity that uses a third-party exempt credit card to purchase the fuel, effective October 1, 2001. Under existing law, an entity whose use of motor fuel is exempt from tax may obtain a refund of the tax it pays on fuel. In the alternative, a person who sells motor fuel to an exempt entity may obtain a refund of the tax it pays on the fuel if it does not pass the tax on to the exempt entity. The prior law also specified that a supplier may issue a card or code to the exempt entity that enables the entity to purchase motor fuel at retail without paying the tax. The supplier is liable if such a card is issued to an entity whose use of fuel is not exempt. The exempt entity is liable if it uses the card to purchase fuel for a purpose other than an exempt purpose. The prior law did not cover a third situation: when a credit card company, rather than the supplier, issues the exempt card. When the exempt entity uses the exempt card to purchase motor fuel, the seller does not charge the entity for the tax but subsequently bills the credit card company for the entire sale, including the tax. The credit card company pays the seller and seeks a refund of the tax from the State. Section 3 of the act provides that the credit card company may obtain a refund of the tax in this situation. Section 4 of the act provides that the credit card company is responsible for determining that the entity to which the card is issued is

exempt, and provides that the credit card company is liable if the card is issued to an entity that is not exempt. Section 5 of the act authorizes the Secretary of Revenue to require a credit card company to file a bond if the Secretary determines after an audit that a bond is necessary to assure collection of tax due pursuant to the audit.

Third, the act expands the situations in which a monthly rather than an annual refund is allowed for motor fuel tax paid on kerosene, effective October 1, 2001. Under existing law, if a person purchases tax-paid fuel and uses it for a non-highway purpose, the person can get an annual refund of the fuel tax (less the applicable sales tax). In addition, a distributor may obtain a monthly refund for fuel tax it pays on kerosene it dispenses into an end user's storage facility that contains fuel used only for heating. This monthly refund is not net of applicable sales tax, but the distributor collects and remits sales tax on the sale to the end user. The act adds two more exempt purposes to the distributor's monthly refund: drying crops and manufacturing. Heating, drying crops, and manufacturing are the same three purposes designated in the statute allowing dyed (untaxed) diesel fuel to be stored in containers installed in a manner that makes it improbable that the fuel can be used for any purpose other than those three.

Finally, Section 2 of the act corrects a cross-reference and Section 7 makes a technical change to the diesel fuel storage statute.

Special Obligation Bonds for Water/Sewer

Session Law #	Bill #	*Sponsor*
S.L. 2001-238	**SB 123**	**Senator Carpenter**

AN ACT TO AUTHORIZE LOCAL GOVERNMENTS TO ISSUE SPECIAL OBLIGATION BONDS FOR WATER AND SEWER PROJECTS.

OVERVIEW: This act expands local governments' existing authority to issue special obligation bonds for solid waste projects to include water and sewer projects.

FISCAL IMPACT: This act will have no direct impact on State or local revenues or expenditures. Once the financing option is used, the local unit will incur debt service requirements. These needs will be funded from the dedicated revenue sources.

EFFECTIVE DATE: This act became effective June 23, 2001.

ANALYSIS: In 1989, the General Assembly authorized local governments to issue special obligation bonds to finance solid waste management projects. This act expands their authority to issue special obligation bonds for the following types of water and sewer projects:

- A water supply system, as defined in G.S. 159G-3.
- A water conservation project, as defined in S.L. 1998-132.
- A water reuse project, as defined in S.L. 1998-132.
- A wastewater collection system, as defined in G.S. 159G-3.
- A wastewater treatment works, as defined in G.S. 159G-3.

A special obligation bond does not require a vote of the people because it does not pledge the taxing power or full faith and credit of the government issuing the bond. The bond is secured by a pledge of designated nontax revenues. The nontax revenues can be fees or they can be

taxes that are levied by another unit of government and shared with the local government that proposes to issue the special obligation bonds. For example, a city can pledge its share of local sales and use taxes because the county levies those taxes. A county can pledge landfill fees or State-shared tax revenue, such as deed stamp tax revenue. Special obligation bonds are sometimes more appropriate than installment purchase financing for solid waste projects because lenders are reluctant to take a security interest in solid waste projects due to potential liability for environmental contamination.

Make Meals Tax Penalties Uniform

Session Law #	*Bill #*	*Sponsor*
S.L. 2001-264	**HB 1448**	**Representative Buchanan**

AN ACT TO PROVIDE UNIFORM PENALTIES FOR LOCAL MEALS TAXES.

OVERVIEW: This act makes all local meals tax penalties uniform by applying the existing State sales and use tax penalty charges to meals taxes. This act will improve tax administration by making the tax penalties for each local meals tax uniform.

FISCAL IMPACT: Four counties and one town are currently collecting a meals tax. They are Cumberland County (S.L. 93-413), Dare County (S.L. 91-177), Mecklenburg County (S.L. 89-821 and S.L. 89-922), Wake County (S.L. 91-954 and S.L. 95-458), and the Town of Hillsborough (S.L. 93-449 and S.L. 99-304). Under prior law, Mecklenburg County collected $177,000 in penalties in the previous fiscal year. Because 98% of that revenue was from the $10 per day penalty, which is not in the sales tax law, they could see a revenue decrease. Wake County will not be impacted as they already adhere to the sales tax law on penalties. Dare County collected $8,090.50 in meals tax penalties in FY 1997-98 and $7,060.66 in the previous year. No estimate is available on how the act will change this revenue stream. No data is available from Cumberland County or Hillsborough.

EFFECTIVE DATE: The act became effective October 1, 2001.

ANALYSIS: G.S. 105-236 sets out the penalties that apply to State taxes, including sales taxes. It provides that the penalty for failure to file is 5% of the tax due per month, up to a maximum of 25%. The penalty for failure to pay tax is 10% of the tax due. In the case of negligence, there is a 10% penalty, which increases to 25% if the amount of the deficiency is more than 25% of the tax liability.

This act extends the above uniform penalty provisions that apply to State sales and use taxes to all local meals taxes. Because local meals taxes are a type of sales tax and the retailers who collect those taxes also collect sales taxes, the tax system is much simpler if taxpayers do not have to keep up with different penalties for different taxes in different localities. The governing board of a taxing city or county is also given the same authority to waive the penalties for a local meals tax that the Secretary of Revenue has to waive the penalties for State sales and use taxes.

Correct Dry-Cleaning/White Goods Laws

Session Law #	*Bill #*	*Sponsor*

S.L. 2001-265	HB 1062	Representative Gibson

AN ACT TO CORRECT CERTAIN ENVIRONMENTAL LAWS RELATING TO THE DRY-CLEANING SOLVENT CLEANUP ACT OF 1997 AND THE MANAGEMENT OF WHITE GOODS.

OVERVIEW: This act makes two changes to the tax laws concerning the dry-cleaning solvent tax and the white goods tax. The act moves up the effective date of a tax increase on dry-cleaning solvents from October 1, 2001, to August 1, 2001, and it restored a prohibition on the taxation of white goods by local governments that was mistakenly repealed in an earlier session.

FISCAL IMPACT: The act generates an additional $87,572 for the Dry-Cleaning Solvent Cleanup Fund. This amount represents the revenue estimated to be generated during the months of August and September 2001 by the dry-cleaning solvent tax.

EFFECTIVE DATE: July 4, 2001.

ANALYSIS: This act makes several changes to the laws regarding the management of white goods and the cleanup of properties contaminated with dry-cleaning solvent. Two of the changes are finance related.

The General Assembly enacted the Dry-Cleaning Solvent Cleanup Act of 1997 to facilitate the cleanup of contamination at dry-cleaning facilities. The 1997 Act provides that owners of dry-cleaning facilities, after satisfying applicable deductibles and co-payments, may seek reimbursement from the Dry-Cleaning Solvent Cleanup Fund (Fund) for costs associated with the cleanup of contaminated dry-cleaning sites. The Fund is funded by a tax on dry-cleaning solvent and by an earmarking of 15% of the revenue generated from the sales tax on dry-cleaning and laundry services. In S.L. 2000-19, the General Assembly increased the tax on the solvent, effective October 1, 2001, from $5.85 to $10 per gallon of dry-cleaning solvent that is chlorine-based and from $0.80 to $1.35 per gallon of dry-cleaning solvent that is hydrocarbon-based. This act moves up the effective date of the increase in the tax rate on dry-cleaning solvent from October 1, 2001, to August 1, 2001.

The act also restores a prohibition on the taxation of white goods by local governments that was mistakenly repealed by legislation in 1998. Since no local governments have taken advantage of this oversight to create their own white goods tax, there is no fiscal impact from these sections. These sections became effective retroactively.

Electronic Listing for Property Taxes

Session Law #	*Bill #*	*Sponsor*
S.L. 2001-279	**SB 365**	**Senator Reeves**

AN ACT TO PROVIDE FOR ELECTRONIC LISTING OF BUSINESS PERSONAL PROPERTY FOR AD VALOREM TAXES AND TO ALLOW COUNTIES TO EXTEND THE LISTING PERIOD FOR ELECTRONIC LISTING.

OVERVIEW: This act authorizes counties to allow electronic listing of business personal property and to extend from January 31 to until June 1 the deadline for listing business personal property electronically.

FISCAL IMPACT: Because the act is permissive, it is not known what impact it may have on counties.

EFFECTIVE DATE: July 13, 2001.

ANALYSIS: This act allows the board of county commissioners to adopt a resolution authorizing the electronic listing of business personal property. If the county commissioners adopt such a resolution, then the assessor must publish this information, including the timetable and procedures for electronic listing, in the notice informing taxpayers of the listing process. The act provides that the listing may be signed electronically. An abstract submitted by electronic listing would be considered filed when received in the office of the assessor.

In 2000, the General Assembly enacted Article 11A of Chapter 66 of the General Statutes, to encourage government agencies to provide electronic access to their services, and Article 11B of Chapter 66 of the General Statutes, to provide for the development of centralized Web portals to allow citizens to access State government services. In 2000, the General Assembly also enacted the Uniform Electronic Transactions Act (UETA), Article 40 of Chapter 66 of the General Statutes. In general, UETA provides a legal framework for electronic transactions and gives electronic signatures and records the same validity and enforceability as manual signatures and paper-based transactions, without changing any of the substantive rules of law that would otherwise apply. UETA applies only to transactions in which each party has agreed to conduct the transaction electronically. UETA sets forth four fundamental provisions:

- A record or signature may not be denied legal effect or enforceability solely because it is in electronic form.
- A contract may not be denied legal effect or enforceability solely because an electronic record was used in its formation.
- Any law that requires a writing will be satisfied by an electronic record.
- Any signature requirement in the law will be met if there is an electronic signature.

This act also authorizes counties to extend the listing period for business personal property listed electronically. Under existing law, a county may, for good cause, give a taxpayer an extension until April 15 to list property. An April 15 deadline is often difficult for taxpayers to meet because the general income tax deadline is also April 15. Under this act, if a county allows electronic listing of business personal property, it may extend the period for electronic listing until as late as June 1. Counties may be reluctant to extend the electronic listing deadline as late as June 1 because this deadline might prevent a county from meeting its budget-making responsibilities in a timely manner. The Local Government Budget and Fiscal Control Act require local governments to have a balanced budget. The tax rate for the upcoming fiscal year, and the appropriations, must be set in the budget ordinance. In order to determine the appropriate tax rate, the tax base must be determined. The budget ordinance must be adopted no later than July 1 and it must be presented to the board at least 10 days prior to its adoption. In fact, many local governments adopt their budget ordinances by mid-June.

Property Tax Homestead Exclusion

Session Law #	*Bill #*	*Sponsor*
S.L. 2001-308	**HB 42**	**Representative Allred**

AN ACT TO PROVIDE PROPERTY TAX REDUCTIONS BY AUTHORIZING LOCAL GOVERNMENTS TO REDUCE PROPERTY TAXES IN LIGHT OF THE GOVERNOR'S UNANTICIPATED RELEASE OF WITHHELD REIMBURSEMENTS AND BY EXPANDING HOMESTEAD PROPERTY TAX RELIEF FOR ELDERLY AND DISABLED HOMEOWNERS.

OVERVIEW: This act amends the property tax homestead exclusion and gives local governments the authority to lower their property taxes as a result of unanticipated revenues. Sections 1 and 2 of the act amend the property tax homestead exclusion in three ways:

- It expands the homestead exclusion amount from $20,000 to the greater of $20,000 or 50% of the tax value of the property. (Recommendation of the Revenue Laws Study Committee)
- It increases the income eligibility amount from $15,000 to $18,000, and for every year thereafter, it adjusts the income amount by a percentage equal to the cost of living adjustment (COLA) percentage used to increase social security benefits for the preceding calendar year. (Recommendation of the Revenue Laws Study Committee)
- It extends the time allowed for a person to submit an application for the exclusion from April 15 until June 1.

The act does not provide for any local government reimbursement. Section 3 of the act gives local governments the authority to lower their property tax rates as a result of unexpected revenues received after July 1, 2001. This authority expires October 1, 2001.

FISCAL IMPACT: There is no fiscal impact on the General Fund. The overall estimated impact on local governments due to changes in the property tax homestead exclusion is as follows:

($ million)

FY 2002-02	*FY 2002-03*	*FY 2003-04*	*FY 2004-05*	*FY 2005-05*
0	(11.8)	(12.0)	(12.2)	(12.5)

No estimate is available for Section 3 of the act, which grants local governments the authority to reduce property tax rates until October 1, 2001.

EFFECTIVE DATE: Sections 1 and 2 of the act become effective for taxes imposed for taxable years beginning on or after July 1, 2002. Section 3 of the act became effective July 1, 2001, and expires October 1, 2001.

HOMESTEAD EXCLUSION ANALYSIS: The homestead exclusion is a partial exclusion from property taxes for the residence of a person who (1) is either age 65 or older or totally and permanently disabled and (2) has an income of not more than $15,000. The current exclusion from property taxes is $20,000. This exclusion amount was last increased in 1996, when it was increased from $15,000 to $20,000. The income eligibility amount was last increased in 1996, when it was increased from $11,000 to $15,000. The income used to determine the income eligibility amount includes moneys received from every source other than gifts or inheritances

received from a spouse, lineal ancestor, or lineal descendant. For married applicants residing with their spouses, the income of both spouses is included, whether or not the property is in both names.

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

This act changes the property tax homestead exclusion in three ways:

- increases the homestead exclusion amount for eligible property owners whose homes are appraised at a value greater than $40,000. The act provides that the homestead exclusion amount is $20,000 or 50% of the tax value of the home whichever is greater. This was a recommendation of the Revenue Laws Study Committee.
- increases the income eligibility amount from $15,000 to $18,000. For every year thereafter, it indexes the income eligibility amount of $18,000 by a percentage equal to the cost-of-living adjustment (COLA) percentage used to increase social security benefits for the preceding calendar year. The automatic COLAs for social security benefits are announced in October of each year. The COLAs are based on increases in the Consumer Price Index for Urban Wage Earners and Clerical Workers from the third quarter of the prior year to the corresponding quarter of the current year in which the COLA is effective. The COLA for 2000 was 3.5%. The Revenue Laws Study Committee had recommended that the income eligibility amount of $15,000 be indexed by a percentage equal to COLA.
- extends the time a person has to apply for the homestead exclusion from April 15 to June 1. Under the existing law, a person must file for preferential property tax classifications during the regular listing period, which ends January 31.[6] However, an application for the homestead exclusion may be made and must be accepted at any time prior to April 15. This act extends this period until June 1.

During the 2001 Session, a total of six homestead bills were introduced.[7]

Authorization for Local Governments to Reduce Property Tax Rate: The act gives local governments the authority to lower their property tax rates as a result of unexpected revenues

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[6] A board of county commissioners may accept an untimely application upon a showing of good cause by the applicant. G.S. 105-307

[7] HB 11 would have raised the income eligibility amount to $25,000. HB 50 and SB 90 would have authorized a constitutional amendment to be considered by voters to give counties the option of further increasing the homestead exclusion amount and the income eligibility amount. SB 298 would have raised the income eligibility amount and the homestead exclusion amount to $25,000. HB 102, recommended by the Revenue Laws Study Committee, would have adjusted the income eligibility amount by the same percentage as the COLA percentage and the exclusion amount to $20,000 or 50% of the value of the property, whichever is greater. HB 42 initially would have increased the income eligibility amount and homestead exclusion amount to $30,000 for the first year, and then indexed these amounts for each year thereafter using the Consumer Price Index.

received after July 1, 2001.[8] This is a one-time change that expired October 1, 2001. This change was proposed after Governor Mike Easley placed the $95 million April 2001 inventory tax reimbursement in escrow because of the budget shortfall and then unexpectedly released the reimbursement to the local governments effective June 30, 2001.[9] Local governments cannot make a change in their property tax rates after July 1 without legislative authorization, because G.S. 159-13 requires that they adopt a budget ordinance no later than July 1.

Enforce Tax Compliance & Equality

Session Law #	*Bill #*	*Sponsor*
S.L. 2001-327, as amended by S.L. 2001-427	**HB 1157**	**Representatives Hackney**

AN ACT TO COMBAT TAX FRAUD, ENHANCE CORPORATE COMPLIANCE WITH TAXES ON TRADEMARK INCOME, ASSURE THAT FRANCHISE TAX APPLIES EQUALLY TO CORPORATE ASSETS, AND CONFORM CORPORATE DIVIDEND TREATMENT TO THE GENERALLY ACCEPTED FORMULA USED IN OTHER STATES.

OVERVIEW: This act makes three corporate tax law changes:

- It clarifies that income from using trademarks in this State is taxable to this State and provides a reporting option for royalty payments between related parties.[10]
- It provides that franchise tax will apply equally to corporate assets held by affiliated LLCs so that a corporation cannot avoid paying franchise tax on its assets by transferring them to an affiliated LLC. It also restates the fraud penalty for willful evasion of franchise tax on these assets.[11]
- It piggybacks the federal dividends received deduction for State corporate income tax purposes.[12]

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[8] Only one county exercised this authority. Anson County lowered its property tax rate from 90¢ to 87¢ on the $100 of appraised value of property subject to taxation.

[9] S.L. 2001-424 repeals all of the State reimbursement payments to local governments, effective beginning with the 2003-04 fiscal year. State reimbursements are amounts distributed to local units to compensate them for revenue lost as a result of the removal by the General Assembly of property from the local sales and use tax base, the local property tax base, or the intangibles tax base. State reimbursements consist of reimbursements for the repeal of the property tax on inventories and on poultry and livestock, the repeal of the intangibles tax, the "homestead exemption" from property tax, and the repeal of local sales and use taxes on food purchased with food stamps.

[10] The Senate initially considered this part of the act in SB 1058, introduced by Sen. Kerr. It was a recommendation of the Governor's Loophole Study Commission and the Governor. The Senate included it as one of its revenue raising items in its budget bill, the 3rd Edition of SB 1005.

[11] The Revenue Laws Study Committee recommended legislation on this issue – SB 242 introduced by Sen. Dalton. It was also a recommendation of the Governor's Loophole Study Commission and the Governor. As a result of study and talks during the session, this act addresses the loophole differently. The Senate included this provision as one of its revenue raising items in its budget bill, the 3rd Edition of SB 1005.

[12] The Governor's Loophole Study Commission and the Governor recommended this provision to the General Assembly. The Senate included it as one of its revenue raising items in its budget bill, the 3rd Edition of SB 1005.

The act also requires the Department of Revenue to report to the Revenue Laws Study Committee on its implementation of this act by December 1, 2001.[13] The Department must also report on the effects of this act to the Committee by May 1, 2002, and December 1, 2002.

FISCAL IMPACT: The fiscal impact of this act is as follows:

($millions)

	FY 01-02	***FY 02-03***	***FY 03-04***	***FY 04-05***	***FY 05-06***
LLC's	$10.5	$11.0	$11.4	$11.7	$12.2
Royalty Provision	20.0	21.0	21.8	22.4	23.3
Subsidiary Dividends	30.8	32.3	33.6	34.5	35.9
Total	**$61.3**	**$64.3**	**$66.8**	**$68.6**	**$71.4**

EFFECTIVE DATE: The LLC franchise tax provision is effective for taxes due on or after January 1, 2002. The other two changes are effective for tax years beginning on or after January 1, 2001.

ANALYSIS:

Royalty Reporting Option

This part of the act enhances corporate compliance with taxes on trademark income by partially closing a loophole that allows a corporation to avoid North Carolina tax on income from using intellectual property in this State when the corporation transfers the intellectual property to a related company in another state. This provision solves the problem as it relates to trademarks and trade names, but does not address other types of intellectual property, such as patents, or other types of intangible assets. The provision is effective beginning with the 2001 taxable year.

The act creates a new statute in the Corporate Income Tax Act addressing trademark payments between related members. It states that royalties received for the use of trademarks in this State are income derived from doing business in this State and thus are subject to North Carolina income tax. Some corporations have argued that an out-of-state investment company's receipt of royalty income from the use of trademarks in this State does not subject the investment company to North Carolina income tax on the royalties. Some corporations have relied on such an argument to create an arrangement to avoid North Carolina tax on their North Carolina income.

For example, a corporation may have substantial profits from operating retail stores or manufacturing facilities in North Carolina. As part of its business, it uses trademarks on these stores or on the goods it manufactures. The operating corporation creates a subsidiary in another state and transfers its trademarks to the subsidiary. It owes the subsidiary royalties for the use of the trademarks in North Carolina. If the operating corporation is late paying these royalties, it also owes the subsidiary late fees. The operating corporation deducts against its North Carolina income the royalties and late fees it owes the subsidiary. The subsidiary likely

[13] The Revenue Laws Study Committee did not meet prior to December 1, 2001, because the 2001 Legislative Session did not end until December 6, 2001. The Department of Revenue sent a memorandum to the Committee's chairs, Sen. John Kerr and Rep. Paul Luebke, on November 30, 2001, reporting on the Department's implementation of the act.

pays little or no tax to another state on these receipts because the receipts may be exempt or apportioned away from that state. The subsidiary's receipts are paid back to the operating corporation as dividends but remain free of North Carolina tax because subsidiary dividends are deductible. As a result of this arrangement, although the operating corporation may generate substantial profits from its retail or manufacturing activities in the State, it ends up paying little or no North Carolina tax on these profits by deducting the royalties and late fees it passes through its subsidiary in another state.

This provision addresses these arrangements first by restating that a company's receipts from royalty payments for the use of trademarks in North Carolina are income from doing business in North Carolina. Then it provides adjustments to assure full and fair accountability of this income in relationship to where it is actually earned. In cases where the recipient of the North Carolina royalty income is unrelated to the payer, the recipient is required to pay tax on the income to North Carolina. In cases where the recipient and the payer are related, they have an option on how the income is reported to North Carolina. Either the payer can deduct the North Carolina royalty payments on its North Carolina return and the recipient can include them on its North Carolina return, or the payer can add them to its North Carolina income and the recipient can deduct them on its North Carolina return.[14]

Equalize Franchise Tax on Corporate Affiliated LLCs

This part of the act closes a loophole that existed in the State's corporate tax laws. Prior to the enactment of this provision, a corporation could avoid paying franchise tax on its assets by transferring them to an affiliated limited liability company (LLC).[15] Under North Carolina law, LLCs are not subject to the franchise tax.[16] In 1997, the North Carolina law regarding LLCs was changed to allow for a single-member LLC. This change had the unintended consequence of opening a loophole in North Carolina tax law. It enabled a corporation subject to North Carolina franchise tax to set up an LLC and transfer assets to the LLC in a tax-free transfer. [17] The assets then held by the LLC would not be subject to the franchise tax. Thus, the corporation could avoid a significant portion of its franchise tax liability by transferring assets into a wholly owned LLC subsidiary without affecting its income tax liability.

This part of the act closes this loophole by requiring a corporation to include in its franchise tax base some or all of the assets of an LLC if (1) the corporation is a member of the LLC and (2) the corporation (and/or members of its affiliated group) is entitled to receive 70% or more of the LLC's assets upon dissolution. If the corporation is entitled to receive 100% of the LLC's assets upon dissolution, the corporation includes 100% of the LLC's assets in its franchise tax base. If

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[14] See *Geoffrey, Inc. v. South Carolina Tax Com'n*, 437 S.E.2d 13 SC, 1993, cert. denied by U.S. Supreme Court, 114 S.Ct. 50 (1993) The South Carolina Supreme Court held that (1) royalty income of a foreign corporation, obtained from trademark licenses issued to an affiliate, could be taxed without violating due process clause and (2) tax could be imposed without violating interstate commerce clause.

[15] A limited liability company is a business entity that is essentially a hybrid of a partnership and a corporation. Like a corporation, an LLC limits the liability of its owners. Like a partnership, an LLC is usually not subject to entity-level taxation.

[16] The State franchise tax is among the oldest taxes in North Carolina. It is a tax on S Corporations and C Corporations for the privilege of doing business in the State. The tax rate is $1.50 per $1,000 of value of the greatest of (1) apportioned net book value of the corporation; (2) 55% of appraised value of real and tangible personal property in NC; or (3) total actual investment in tangible property in NC.

[17] S.L. 2001-508 simplified this transfer by permitting the board of directors of a corporation to transfer corporate assets to a wholly owned limited liability company, limited partnership, registered limited liability partnership, or any other unincorporated entity *without the approval of the shareholders*.

the corporation is entitled to receive less than 100% of the LLC's assets, then the corporation includes in its franchise tax base only that percentage of the LLC's assets that it would be entitled to receive upon dissolution. If a corporation is required to include an LLC's assets in its franchise tax base, it is allowed to exclude its investment in the LLC from its franchise tax base. This provision is effective beginning with the 2002 tax year.

In the act, the General Assembly stated its intent to apply the franchise tax equally to assets held by corporations and assets held by corporate-affiliated limited liability companies. To this end, the act provides that a taxpayer who fraudulently underpays the franchise tax on assets it transfers to an affiliated LLC is guilty of a Class H felony, the existing law penalty for tax fraud.

Conform North Carolina's Subsidiary Dividend Deduction to the Generally Accepted Treatment Used in Other States

This part of the act repeals North Carolina's dividends received deduction and instead piggybacks the federal law. The act also equalizes the tax treatment of domestic and foreign source dividends by providing that dividends of foreign corporations may be deducted from taxable income to the extent they are included in federal taxable income.[18] Adopting the federal approach simplifies tax administration and compliance. To the extent North Carolina income tax law conforms to federal law, tax administration and compliance are simplified because the taxpayer is required to make fewer adjustments to taxable income in order to calculate State net income. This part of the act became effective beginning with the 2001 tax year.

Prior to this tax law change a corporation could deduct all dividends received from corporations in which it owned more than 50% of the outstanding voting stock from its State taxable income. Under the federal approach, a parent company may continue to receive a 100% deduction if it is owns 80% or more of the stock of a subsidiary. If a parent company owns more than 50% but less than 80% of a subsidiary, the amount of its deduction is reduced from 100% under prior law to 80% under this act. If a company owns 50% or less of another company, it has no dividends deduction under North Carolina law prior to this act but will get a dividend deduction of either 70% or 80% under the act. Thus some parent companies should gain under the act and some should lose. If a parent company is subject to the federal cap limiting deductible dividends to 70% or 80% of its taxable income, the limit will reduce the amount it can deduct for North Carolina purposes.

The federal deduction is a gross deduction. However, under G.S. 105-130.5(c)(3), the dividend deduction for US companies under North Carolina tax law is net of related expenses. S.L. 2001-427 amended this act to clarify that foreign source dividends must also be net of related expenses so that they would be treated the same for state income tax purposes as domestic source dividends.[19]

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[18] Under federal law, foreign dividends are generally included in income and the taxpayer is allowed a credit for foreign tax paid.

[19] G.S. 105-130.5(c)(3) does not apply to adjustments made under G.S. 105-130.5(a) or (b). Since the deduction for foreign source dividends is contained in G.S. 105-130.5(b), the proviso in G.S. 105-130.5(c)(3) requiring that the expenses be netted does not apply. See also the summary for S.L. 2001-427, HB 232.

Modify Partnership Tax Credit

Session Law #	**Bill #**	*Sponsor*
S.L. 2001-335	**HB 146**	**Representative Luebke**

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

OVERVIEW: This act corrects and clarifies the law governing allocation of partnerships' tax credits, so that any dollar amount limitation on a credit allowed to a partnership applies to the total credit. The limited amount is then allocated by the partnership among the partners on a proportional basis. The original bill was a recommendation of the Revenue Laws Study Committee.

FISCAL IMPACT: There is no available data to determine the General Fund revenue gain that will result from this act.

EFFECTIVE DATE: The act became effective beginning in the 2002 tax year, except that its effect on real property donation credits is delayed until 2005.

ANALYSIS: Generally, partnerships are treated under North Carolina law as under federal law. Both North Carolina and federal law recognize that a partnership is a separate entity. When the partnership is entitled to a tax credit, the partnership allocates the credit among its partners on a proportional basis. The partners can then claim the amount of credit allocated to them. This is done because the partnership itself is not a taxable entity. Under prior North Carolina law, a partnership that passed an income tax credit through to its partners would be subject to all limitations on the credit, except for two[20]:

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

Federal law does not recognize the second of these, the exemption from a specific dollar amount limitation. Additionally, North Carolina law does not recognize such an exemption for S corporations[21]. Thus, this provision of North Carolina law regarding taxation of partnerships was inconsistent with both federal law regarding taxation of partnerships and North Carolina law regarding taxation of S corporations.

This act removes the partnership's exemption from the specific dollar amount limitation. This makes North Carolina law consistent with federal law on this point as well as consistent with North Carolina law regarding S corporations. Limited liability companies are treated like partnerships under North Carolina law for income tax purposes. Thus, this change also applies to limited liability companies.

The change affects relatively few tax credits. The following tax credits have specific dollar amount limitations:

- Worker training (G. S. 105-129.11)

[20] All limitations on the tax credit also apply to each partner individually.

[21] An S corporation is a business entity that is similar in most respects to a partnership for tax purposes.

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

The act delays until 2005 the imposition on partnerships and limited liability companies of the dollar amount limitation on the credit allowed for real property donations. The credit for real property donations is allowed when a person makes a qualified donation of an interest in real property that is useful for public beach access, public access to public waters or trails, fish and wildlife conservation, or other similar land conservation purposes. The credit is equal to 25% of the fair market value of the donated property interest. To be eligible for the credit, the interest in property must be donated 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 Internal Revenue Code. The credit amount may not exceed $250,000.

Streamlined Sales and Use Tax Agreement

Session Law #	**Bill #**	*Sponsor*
S.L. 2001-347, as amended by S.L. 2001-489.	**SB 144**	**Senator Kerr**

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

OVERVIEW: S.L. 2001-347 establishes the Uniform Sales and Use Tax Administration Act. Most of the provisions in the Act are provisions the General Assembly enacted last year.[22] The act also simplifies North Carolina's sales and use tax laws by adopting many of the uniform provisions required under the Act to be adopted before the State can participate in the Streamlined Sales and Use Tax Agreement. The purpose of this Agreement is to develop a substantially simplified sales tax system that can better accommodate interstate commerce and thereby help equalize the playing field between remote (catalog and internet) vendors and Main Street merchants. The act is a recommendation of the Revenue Laws Study Committee.

Nineteen other states and the District of Columbia enacted legislation in 2001 authorizing participation in the Streamlined Sales and Use Tax Agreement: Arkansas, Florida, Illinois, Indiana, Kentucky, Louisiana, Maryland, Michigan, Minnesota, Nebraska, Nevada, North Dakota, Oklahoma, Rhode Island, Tennessee, Texas, Utah, Wisconsin, and Wyoming.

[22] S.L. 2000-120 began the first step in simplifying and streamlining the sales and use tax collection system for remote and in-state retailers. It authorized the Secretary of Revenue to enter into the Streamlined Sales Tax Agreement and made statutory changes to enable North Carolina to enter the Agreement.

FISCAL IMPACT: The changes are expected to create a small but unquantifiable revenue increase.

EFFECTIVE DATE: Part 1 of this act, establishing the Uniform Sales and Use Tax Administration, became effective August 8, 2001. Part 1 expires January 1, 2006, unless one of the following occurs: (i) 15 states have signed the Streamlined Sales and Use Tax Agreement, or (ii) states representing a combined resident population equal to at least ten percent (10%) of the national resident population, as determined by the 2000 federal decennial census, have signed the Agreement. Part 2 of the act, shifting mill machinery and mill machinery parts and accessories from a sales tax to a privilege tax of the same rate, becomes effective January 1, 2006. The remainder of Part 2 of this act became effective January 1, 2002.

BACKGROUND: In 2000 the Revenue Laws Study Committee recommended, and the General Assembly enacted, legislation to enable North Carolina to participate in the Streamlined Sales Tax Pilot, which is part of the Streamlined Sales Tax Project. The Project is an initiative created by state governments, with input from local governments and the private sector, to simplify and modernize sales and use tax administration for all types of commerce. The Project is focused on improving sales and use tax administration systems for both Main Street and remote sellers for all types of commerce. By July 2001, at least 32 of the 45 states that have a sales and use tax were participating in the project and another six states were observing. A "Participating" state is one where the Governor has signed an Executive Order or the legislature has passed legislation authorizing state personnel to participate in the discussion of the Project. "Observer" states represent those states that have expressed an interest in the Project's mission but have not received the executive or legislative authorization to become a Participating state. North Carolina is one of the most active of the participating states involved in the Project. This State, along with Kansas, Michigan, and Wisconsin, are the four states involved in the Streamlined Sales Tax Pilot.

The key features of the Streamlined Sales Tax System include:

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

The North Carolina General Assembly made several changes in the 2000 Regular Session of the 1999 General Assembly in anticipation of the Streamlined Sales Tax Project. These changes included the following: simplified exemption administration, uniform audit procedures, certification of software and tax collectors, uniform sourcing rule, limitation of local government rate changes to twice a year, and payment provisions. S.L. 2001-347 builds upon this earlier legislation. It continues to raise issues that need to be resolved if North Carolina is to enter into the Streamlined Sales Tax Agreement. As the model legislation continues to be developed, the State will need to address other issues raised by it.

ANALYSIS: **Part 1** of the act establishes the Uniform Sales and Use Tax Administration Act. It authorizes the Secretary of Revenue to enter into the Streamlined Sales and Use Tax.

Agreement. However, the Secretary may not enter into the Agreement unless the Agreement requires each state to abide by the following requirements:

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

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

Part 2 of the act makes conforming changes by beginning the process of establishing uniform rates, standards, and definitions that are required to enter into the Streamlined Sales and Use Tax Agreement.

Conforming Changes: Uniform Definitions

Sections 2.1 through 2.5 add or amend the following definitions to the State's sales and use tax laws: candy, delivery charges, dietary supplements, food, food sold through a vending machine, purchase price, soft drink, prepared food, retail sale, and sales price. Sections 2.18 through 2.22 conform the definition of prepared food used in the local prepared meals tax acts with the one amended by Section 2.3. Use of the defined terms results in the following changes to the State's sales and use tax laws:

- What food is exempt from sales tax.– The act, as amended by Sections 3.(a) and 3.(b) of S.L. 2001-489, maintains the current exemption for foods that may be purchased with food stamps. The food stamp program applies to food purchased for home consumption. The act, as amended, provides that candy, prepared food, and soft drinks are taxed unless they are purchased for home consumption and would be exempt if

purchased under the Federal Food Stamp Program.[23] Alcoholic beverages, dietary supplements, and food sold through a vending machine also continue to be taxed under G.S. 105-164.13B, as amended in S.L. 2001-489.[24]

- Delivery charges – Under the uniform act, all delivery charges are included in the sales price of an item and therefore subject to tax. Under prior law, delivery charges may or may not have been included as part of the sales price, depending upon where the title to the property passed to the purchaser. Under this act, all delivery charges are included in the definition of "sales price" and are subject to tax. Section 2.11 repeals the law concerning freight and delivery transportation charges.
- Installation charges – Under the uniform act, installation charges are included in the sales price. The act includes them in the definition of "sales price", but Section 2.12 maintains the current exemption by specifically providing that installation charges are exempt from sales and use tax.
- Food purchased from vending machines – Under the uniform act, food purchased from vending machines is considered food. Prior to the act, North Carolina taxed food purchased from vending machines, because it was not considered food for home consumption. However, the State's definition of sales price provided that any tangible item purchased through a vending machine, other than closed container soft drinks or tobacco products, would be taxed at 50% of its sales price. Section 2.13 of the act, as amended in Section 3.(b) of S.L. 2001-489, provides that food purchased through a vending machine is subject to tax. However, Section 2.12 maintains the 50% exemption by specifically listing it as an exemption from the sales and use tax.
- Certain deposits – Prior to the act, certain deposits on beverage containers and certain deposits on aeronautic, automotive, industrial, marine, or farm replacement parts were not subject to sales and use tax because they were not considered part of the sales price, as that term was defined. These deposits are considered part of the sales price under the uniform definition in Section 2.5. However, Section 2.12 maintains the exemption by adding these deposits to the list of items exempt from sales and use tax.

Section 2.6 conforms the definition of "use" for sales and use tax purposes to the definition used in neighboring states. The change in the definition provides that the use tax is applicable to the distribution of direct mail catalogs printed out-of-state to instate residents by a business that has nexus with the State. The definition in the act is consistent with the U.S. Supreme Court's decision in *D.H. Holmes v. McNamara,* 486 U.S. 24 (1988).

Section 2.7 recodifies some of the current definitions so that the definitions added by this act can be placed in the correct alphabetical order.

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[23] Section 2.13 of the act arguably broadened the sales tax exemption for prepared foods to include all take-out food items from restaurants and fast food chains and all catered food. These food items are taxable under current law. An exemption for take-out food items would have resulted in a General Fund loss of approximately $60 million a year.

[24] Section 2.2 of the act excluded alcoholic beverages from the definition of food in the uniform act. Because local meals tax laws are linked to the sales tax definitions, this language would have inadvertently exempted prepared alcoholic beverages (beer, wine, and mixed drinks) from the local meals taxes.

Conforming Changes: Uniform Sourcing Rules

Section 2.9 adopts the sourcing rule established in the Streamlined Sales and Use Tax Agreement. Under prior law, the sale of a product was determined by the location of the retailer's business. Under the act, the sale of a product is determined by the location where the purchaser receives the product.

- If the purchaser receives the product at a business location, then the sale is sourced to that business location.
- If the purchaser receives the product at a location specified by the purchaser and the location is not a business location of the seller, then the sale is sourced to the location where the purchaser receives the product.
- If the seller does not know the address where a product is received, then the sale is sourced to either the business or home address of the purchaser, the billing address of the purchaser, or the address of the seller.

This sourcing rule does not apply to telecommunications services.[25]

Sections 2.10, 2.15, and 2.16 provide that the uniform sourcing rule established in Section 2.9 applies to the State use tax and to the local sales and use tax acts. The rule will impact the distribution of the 1 cent[26] local sales and use tax revenue distributed on a point-of-origin basis.[27] Under prior law, G.S. 105-467 stipulated that the situs of a transaction was the retailer's place of business. Under the sourcing rule, a retailer does not need to maintain sales tax records indicating where a product is shipped. However, under the destination-sourcing rule, a retailer will have to submit sales tax reports indicating the counties where a product is shipped so that the tax revenue from that sale can be correctly distributed to that county. It is unknown what impact the uniform sourcing rule will have on the distribution of the 1 cent local sales and use tax revenue.[28]

Conforming Changes: Uniform Rate

The Uniform Sales and Use Tax Administration Act requires a state to have a limited number of sales and use tax rates. The states have until 2005 to simplify their rates. This act begins the process of simplifying North Carolina's rates by exempting mill machinery and mill machinery parts and accessories from the sales and use tax and imposing in its place a privilege tax on these items. The privilege tax rate would be the same as the current sales and use tax rate: 1% of the sales price of the machinery, part, or accessory purchases, subject to a maximum tax of

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[25] See S.L. 2001-430, as amended by S.L. 2001-424 and S.L. 2001-487, for the tax treatment of telecommunications services.

[26] 1.5 cent for Mecklenburg County.

[27] Article 39 of Chapter 105. The two ½ cent local sales and use taxes, Articles 40 and 42 of Chapter 105, are distributed on a per capita basis.

[28] Prior to March 1, 1988, North Carolina used a destination-based sourcing rule for the situs of the 1 cent local sales and use tax. In S.L. 1987-832, the General Assembly stipulated that the situs of a sale was considered to be the retailer's place of business. This change in situs from the purchaser's county to the seller's county would have resulted in a shift of revenues by certain counties. To hold counties harmless, the General Assembly adjusted the two ½ cent taxes which are distributed on a per capita basis. Although this act returns the sourcing of a sale to the purchaser's county, it does not repeal the adjustment factors in G.S. 105-486. This correlation between the adjustment factors and the local sourcing rule was not raised in the discussion of this act.

$80. This change in the law means that retailers are not responsible for collecting and remitting the tax.

Section 2.8 repeals the current sales and use tax rate of 1%, $80 cap on mill machinery and mill machinery parts and accessories. Section 2.12 adds mill machinery and mill machinery parts and accessories to the list of exemptions from the sales and use tax. Section 2.17 establishes the privilege tax on mill machinery. These changes in Sections 2.8, 2.12, and 2.17, do not become effective until January 1, 2006.

Conforming Changes: Administration of Returns

The Streamlined Sales Tax Agreement provides that a taxpayer would file only one return a month. Under prior law, taxpayers who were consistently liable for at least $20,000 a month in State and local sales and use taxes were required to pay the tax and file a return twice a month. Section 2.14 provides that the taxpayer must pay the tax owed twice a month, but only needs to file the return once a month. The monthly return must cover both semimonthly payments.

DOR Debt Collection Changes

Session Law #	*Bill #*	*Sponsor*
S.L. 2001-380	**SB 353**	**Senator Kerr**

AN ACT TO PROVIDE A PERMANENT MECHANISM FOR THE COLLECTION OF TAX DEBTS.

OVERVIEW: Since 1999, the General Assembly has authorized a pilot program for the collection of tax debts owed by nonresidents and a study of the Department of Revenue's delinquent collection practices. "Project Collect Tax", an initiative of the Department to collect at least $100 million in overdue taxes in the 2001-03 biennium, is an outgrowth of these efforts. This act enables the Department to execute its "Project Collect Tax" by making the following changes in the tax laws:[29]

- It makes permanent the Department's authority to use collection agencies to collect out-of-State tax debts.
- It authorizes the Department to use collection agencies to collect in-State tax debts for two years.
- It imposes a collection assistance fee of 20% on all tax debts that remain unpaid for 90 days after they become final.
- It allows the Department to use the receipts from the collection assistance fee to provide the resources needed for "Project Collect Tax".

FISCAL IMPACT: This act enables the Department of Revenue to launch its "Project Collect Tax" to reduce its $370 million backlog in accounts receivables. The Department plans to bring in $50 million in additional revenue in FY 2001-02 and the same amount in FY 2002-03. This additional revenue was included in the Current Operations and Capital Improvements Appropriations Act of 2001, S.L. 2001-424.

[29] The General Assembly also appropriated funds for 52 new positions in the Department of Revenue and 12 contract positions for Project Collect Tax.

EFFECTIVE DATE: Except as noted in the analysis, the act became effective on August 20, 2001.

ANALYSIS:

Outsourcing Tax Debts

In 1999, the General Assembly provided the Department of Revenue a source of funds to contract for the collection of tax debts owed by nonresidents and foreign entities for the 1999-2000 biennium. A tax debt is the amount of tax, interest, and penalties due for which a final notice of assessment has been mailed to the taxpayer after the taxpayer no longer has the right to contest the debt. In September 2000, the Department, in conjunction with the Office of the State Auditor, began outsourcing some of its out-of-state tax debts. Between September 2000 and May 2001, it collected in excess of $12 million in out-of-state receivables using a combination of outsourcing and in-house collection techniques.

The cost of contracting for the collection of these tax debts was retained from the taxes collected. The actual cost of collection for the Department of Revenue on the outsourced tax debts was what the contractor charged the Department to collect the debt. The contractor charged a percentage of the amount collected. That percentage averaged 20% of the tax debt. As the number of tax debts outsourced to a contractor increases, the percentage amount charged to the Department to collect the debt is expected to decrease.

This act substitutes a broader debt collection program for the pilot program. Under this program:

- The Department of Revenue may outsource out-of-state tax debts permanently and may outsource in-state tax debts for two years.[30]
- The cost of collecting tax debts that are at least 90 days overdue is shifted from the State's general revenues to the delinquent taxpayer, by providing that the taxpayer must pay a collection assistance fee of 20% of the overdue tax debt.[31]

The act provides permanent authority for the Department of Revenue to outsource tax debts as long as it continues its practice of notifying the taxpayer prior to submitting the debt to a collection agency. The taxpayer has 30 days after the notice is sent to pay the tax debt. If the debt remains unpaid at the end of the 30 days, then the debt may be outsourced to a collection agency. The collection agencies that contract to collect tax debts are prohibited from revealing confidential tax information. If a contractor reveals tax information, it is subject to a misdemeanor penalty, its contract is terminated, and it is barred from contracting again for five years.

The act also establishes a system under which the cost of collecting overdue tax debts is to be borne by the delinquent taxpayers, not by the taxpayers who pay their taxes on time. The act provides that a collection assistance fee is imposed if the Department gives the taxpayer 30

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[30] Section 8 of the act provides that the authority to outsource tax debts owed by North Carolina taxpayers sunsets October 1, 2003. During this two-year period, the Department would like to outsource low priority in-state tax cases to a collection agency. The Department anticipates referring income tax assessments with a value of $25.00 to $500.00 in initial referrals.

[31] The act states the General Assembly's findings that the Department of Revenue's cost of collecting overdue tax debts equals or exceeds 20% of the tax debts and that the cost of collecting overdue tax debts is currently borne by taxpayers who pay their taxes on time. It is the General Assembly's intent that the collection assistance fee will pass that cost on to delinquent taxpayers who owe overdue tax debts.

days' notice and the taxpayer does not pay the debt within that period. The 30-day fee notice cannot be mailed until at least 60 days after the final assessment for the tax debt, with the result that the fee applies only to tax debts that remain unpaid for 90 days or more after final assessment. The fee does not apply to a tax debt if the taxpayer entered into an installment agreement within 90 days after the final assessment and remains current with payments under the agreement. In addition, the Secretary of Revenue may waive the fee in other situations to the same extent as if the fee were a penalty.

The collection assistance fee is 20% of the overdue tax debt and is a receipt of the Department. The proceeds of the fee are credited to a special, non-reverting account to be used only for collecting overdue tax debts.[32] The Department of Revenue may apply the fee proceeds to pay contractors for collecting tax debts and to pay the fee charged by the federal government for collecting tax debts by offset. The remaining proceeds of the fee may be spent for collecting overdue tax debts only pursuant to appropriation by the General Assembly.

The Department of Revenue must report periodically on its debt collection activities to the Joint Legislative Commission on Governmental Operations and to the Revenue Laws Study Committee.[33] The reports must include a breakdown of the amount and age of tax debts collected by collection agencies on contract, tax debts collected by the Department through warning letters, and tax debts otherwise collected by Department personnel. They must also include a long-term collection plan, a timeline for implementing each step of the plan, a summary of steps taken since the last report and their results, and any other data requested.

The act makes several conforming changes:

- The State submits some tax debts for collection through the U.S. Department of the Treasury Offset Program. Under prior law, the Department of Revenue imposed a $15.00 collection assistance fee on each tax debt collected through the federal Treasury Offset Program. Because this act imposes a collection assistance fee on all overdue tax debts, the act repeals the fee that applied to debts submitted to the federal Treasury Offset Program, in order to avoid a double fee.
- It deletes a redundant provision allowing the Secretary of Revenue to contract for debt collection.
- It adds a provision to the Tax Secrecy Law allowing the Secretary of Revenue to provide the necessary information to collection agencies to allow them to identify the taxpayers and the amount of the overdue tax debts to be collected.
- It provides funds to pay debt collectors for debts outsourced in the 2000-2001 fiscal year but not collected until after July 1, 2001. The existing law provided authority to pay debt collectors for outsourced debts during the 2000-2001 fiscal year but, because of the time required to collect tax debts, some debts outsourced during the 2000-2001 fiscal year were not collected until after July 1, 2001. For these debts, this act provides that the debt collector may be paid from the proceeds collected.

Centralize and Automate Debt Collection System

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[32] The Current Operations and Appropriations Act of 2001, S.L. 2001-424, Section 14D.1, provides that the proceeds of the fee are to be transferred to a separate Fund Code in the Department of Revenue's budget.

[33] The reports must be submitted quarterly beginning November 1, 2001, and semiannually beginning November 1, 2002.

In 1999, the General Assembly authorized the Department of Revenue and the Office of the State Controller to conduct a study of the Department's delinquent collection practices. The Office of the State Controller's existing contract with PricewaterhouseCoopers (PwC) was modified and PwC conducted the study. PwC recommended that the Department centralize its collection process, make technology upgrades such as telefile and predictive telephone calling, and implement an automated case management tool with debt scoring and performance measures. PwC projected that the impact of this recommendation would be an increase of delinquent tax collections by $11 million to $30 million annually. To implement this recommendation, the Department will enter into a performance-based contract where the person who provides the automated system would be paid from the proceeds of the system based upon some variable that pertains to how well the system works. Last year, the General Assembly authorized the Secretary of Revenue to use General Fund revenues collected in fiscal year 2000-2001 to obtain assistance in developing a request for proposals for the performance-based contract. However, with the fiscal crisis the State was experiencing, the Office of State Budget and Management asked the Department to delay this effort until after July 1, 2001. The act allows the Department of Revenue to spend up to $500,000 from the collection assistance fee account during the 2001-2002 fiscal year to develop and bid the contract.[34]

Car Property Tax Credit

Session Law #	*Bill #*	*Sponsor*
S.L. 2001-406	**HB 1431**	**Representative Hackney**

AN ACT TO PREVENT DOUBLE TAXATION OF MOTOR VEHICLES WHOSE TAX YEAR CHANGES DUE TO A CHANGE IN REGISTRATION.

OVERVIEW: This act prevents double property taxation on a motor vehicle whose tax year changes due to a change in registration.

FISCAL IMPACT: There is no General Fund impact due to this act. A few counties that did not already offer a tax release or credit in this situation may see a minimal fiscal impact.

EFFECTIVE DATE: September 14, 2001.

ANALYSIS: Under existing law, a taxpayer may receive a release or refund of property taxes paid on a motor vehicle if the taxpayer surrenders the motor vehicle's registration plates because the person has transferred the vehicle to a new owner or because the person has moved out-of-state and registered the vehicle in that state. However, before this act went into effect, the law did not address the situation when a person surrenders a motor vehicle's registration plates for other reasons and later re-registers the vehicle, occasionally resulting in double taxation. For example, a person leaves the country for an extended period of time and does not wish to keep the motor vehicle insured while away. The person can surrender the vehicle's registration plates and cancel the vehicle's insurance. The person has already paid that year's property taxes on the vehicle. Upon returning to the country, the person must register the

[34] The Current Operations and Appropriations Act of 2001, S.L. 2001-424, Section 14D.2, requires the Department of Revenue to report to the Joint Legislative Commission on Governmental Operations monthly on its progress in developing the RFP. The Department must consult with the Commission before it can issue the RFP.

motor vehicle again and obtain new registration plates. The registration triggers a new property tax bill and a new property tax year. If the vehicle's new registration is obtained before the vehicle's original registration would have expired, then the taxpayer is paying property taxes twice on the vehicle for those months remaining in the vehicle's original tax year.

This act allows the county tax collector to give a taxpayer a credit against the taxes owed on a motor vehicle if both of the following conditions are met:

- The tax year for the vehicle changes because of a change in the vehicle's registration year for a reason other than the transfer of its registration plates to another vehicle.
- The vehicle's new tax year begins before the expiration of the vehicle's original tax year.

The amount of the credit is equal to 1/12 of the amount of taxes paid on the vehicle for its original tax year times the number of full calendar months remaining in the original tax year as of the first day of the new tax year. The credit is given in the form of a release against the taxpayer's taxes for the new tax year. To obtain the credit, the taxpayer must apply within 30 days after the taxes for the new tax year are due and must provide the county tax collector information establishing the vehicle's original tax year, the amount of taxes paid on the vehicle for that year, and the reason for the change in registration.

Mulch Blower Fuel Tax Refunds

Session Law	*Bill #*	*Sponsor*
S.L. 2001-408	**HB 170**	**Representative Walend**

AN ACT TO ALLOW A FUEL TAX REFUND FOR OFF-ROAD FUEL USE BY MULCH-BLOWING EQUIPMENT.

OVERVIEW: This act allows a commercial vehicle that delivers and spreads mulch and similar materials and that uses a power takeoff to deliver or unload the materials to receive a partial annual refund of the motor fuel taxes paid on the fuel consumed by the vehicle.

FISCAL IMPACT: With only three companies and eight trucks that qualify for this refund, the cost to the Highway Fund and Highway Trust Fund is approximately $2,000 per year. There is a $200 to $300 gain to the General Fund from sales tax.

EFFECTIVE DATE: Applies to motor fuel consumed on or after January 1, 2001.

ANALYSIS: G.S. 105-449.107(b) allows annual refunds of motor fuel and alternative fuel taxes for certain vehicles with power attachments fueled by motor fuel. This reflects the policy that the motor fuel tax is intended to apply only to fuel used for highway purposes and that the sales tax applies to fuel used for other purposes. Before this act went into effect, only the following vehicles were allowed an annual partial refund of the motor fuel and alternative fuel taxes paid on fuel consumed by the vehicles:

- A concrete mixing vehicle.
- A solid waste compacting vehicle.
- A bulk feed vehicle that delivers feed to poultry or livestock and uses a power takeoff to unload the feed.

- A vehicle that delivers lime or fertilizer in bulk to farms and uses a power takeoff to unload the lime or fertilizer.
- A tank wagon that delivers alternative fuel or motor fuel or another type of liquid fuel into storage tanks and uses a power takeoff to make the delivery.

The annual partial refund of the fuel taxes is equal to 33 1/3% of the following: (i) the flat cents-per-gallon rate in effect for the year for which a refund is claimed, plus (ii) the average of the two variable cents-per-gallon rates in effect during that year, less (iii) the amount of sales and use tax due on the fuel. This formula assumes that one-third of the fuel that is used by the vehicle is used in its mixing, compacting, or unloading operations as distinguished from propelling the vehicle on the roads.

This act allows an additional type of vehicle to qualify for the refund: a commercial vehicle that delivers and spreads mulch, soils, composts, sand, sawdust, and similar materials and uses a power takeoff to unload, blow, and spread the materials. The same formula is used to determine the amount of the refund.

Revenue Laws Technical Changes

Session Law #	*Bill #*	*Sponsor*
S.L. 2001-414	**SB 165**	**Senator Hartsell**

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

OVERVIEW: This act makes numerous technical and clarifying changes to the revenue laws and related statutes. The original bill was a recommendation of the Revenue Laws Study Committee.

FISCAL IMPACT: No State or local fiscal impact.

EFFECTIVE DATE: The Goodness Grows license plate change is effective retroactively to August 2, 2000. The streamlined sales tax conforming changes are effective January 1, 2002. The remainder of the act became effective September 14, 2001.

ANALYSIS: The following table provides a section-by-section summary of the act:

SECTION	G.S./S.L.	EXPLANATION
1	SL 2000-56	Corrects an incorrect section number reference in a session law.
2	GS 105-111	Repeals an obsolete statute (Duties of Secretary of Revenue relating to privilege licenses).
3-5	GS 105-113.21(a) GS 105-113.39 GS 105-113.85	Conform the discount statutes for the excise taxes on tobacco products and the excise taxes on beer and wine to a uniform rule that requires both timely filing and timely payment. Sections 3 and 4 clarify that a distributor of tobacco products must send a timely payment as well as filing a timely report to receive the

SECTION	G.S./S.L.	EXPLANATION
		4% discount. Section 5 deletes a gender-specific phrase and clarifies that a wholesaler or importer of wine or malt beverages must send a timely payment and file a timely report to receive the 4% discount.
6	GS 105-129.3A(c)	Corrects an incorrect cross-reference.
7	GS 105-129.4(b)	Clarifies that the Bill Lee Act's wage standard test must be measured based on all full-time jobs, including those subject to seasonal layoffs.
8	GS 105-129.8(a)	Corrects an incorrect word and conforms terminology.
9	GS 105-129.13(c)	Adds missing words.
10	GS 105-129.19	Designates the Revenue Laws Study Committee rather than the Legislative Research Commission to receive a Department of Revenue report on tax credits.
11	GS 105-151.21(b)(1)	Conforms a cross-reference to a statute that has been recodified.
12	GS 105-163.013(g)	Designates the Revenue Laws Study Committee rather than the Legislative Services Commission to receive the Secretary of State's report on businesses that have registered as a qualified grantee business or a qualified business venture.
13	GS 105-163.41	Clarifies that corporate estimated tax payments are based on net tax due minus allowable credits.
14	G.S. 105-164.3(4)	Repeals the sales tax definition of "cost price", which is no longer needed because S.L. 2001-347 defines the term "purchase price" to replace the term "cost price". Effective January 1, 2002.
15-19	GS 105-164.6(a) GS 105-164.12B(a) GS 105-164.12B(f) GS 105-164.16(a) GS 105-164.23	Change the term "cost price" to "purchase price" to conform to the change made by S.L. 2001-347. Effective January 1, 2002.
20	GS 105-164.27A(d)	Supplies missing word.
21-22	GS 105-164.32 GS 105-187.16	Change the term "cost price" to "purchase price" to conform to the change made by S.L. 2001-347. Effective January 1, 2002.

SECTION	G.S./S.L.	EXPLANATION
23	GS 105-228.90	Adds reference in Chapter 105 to the timber tax levied in Chapter 113A of the General Statutes, which is collected by the Department of Revenue.
24	GS 105-249.2	Adds subheadings.
25	GS 143B-218.1	Recodifies a reporting requirement into Chapter 105 of the General Statutes.
26	GS 105-256	Adds cross-references to reporting requirements codified outside of Chapter 105 of the General Statutes.
27	GS 105-449.60(41)	Corrects misspelling.
28	GS 105-446(c)	Deletes duplicate phrase.
29-30	GS 105-467 Chapter 1096 of the 1967 Session Laws	Conforms the local sales tax definition of food with the changes made by S.L. 2001-347. Effective January 1, 2002.
31	GS 20-87(6)	Changes $3 motorcycle charge from "tax" to "fee" and provides that any revenue from the motorcycle fee, in addition to any other funds appropriated for this purpose, shall be used to implement the Motorcycle Safety Instruction Program.
32	GS 20-79.7(b)	Corrects the distribution amounts of a $25 license fee. (Fees for the "Goodness Grows" license plate were set at $25; however, the distribution amount was inadvertently set at $20.) Effective retroactively to August 2, 2000.
33	GS 69-25.4	Clarifies that a fire protection district is a unit of local government. Article V, Section 2(5) of the NC Constitution allows the General Assembly to authorize units of local governments to levy taxes on property. Article 3A of Chapter 69 of the General Statutes authorizes a fire protection district to levy property taxes, subject to a referendum; however, it does not define what a fire protection district is. Article 3A was enacted in 1951, prior to the rewrite of the Constitutional provision in 1969. This section explicitly provides that a fire protection district is a municipal corporation organized for a special purpose.
34-44	GS Ch. 96	Conforms Employment Security law's references to Internal Revenue Code, clarifies wording, and conforms structure of G.S. 96-12.01

SECTION	G.S./S.L.	EXPLANATION
45-46	GS Ch. 116	Clarifies internal cross-references in Chapter 116D (Higher Education Bonds).
47	GS 143B-221	Repeals a statute that no longer serves its given purpose. The statute sets out how the Department of Revenue would be initially organized. The Department is no longer organized under this statute; it is organized under the general provisions for the organization of State agencies in G.S. 143B-10.
48—50	GS Ch. 159	Clarifies that a municipality participating in a joint venture or undertaking may issue revenue bonds to finance its portion of the undertaking.
51	GS 160A-215.1(e)	Supplies a missing word.
52	S.L. 97-380	Repeals the session law that established the Forsyth-Guilford Metro. Baseball Park District and provided for a referendum on a baseball park. (The voters defeated the proposal, and the entity has no assets or liabilities.)
53	Effective Dates	Except as follows, the act became effective September 14, 2001: • *Section 32 (dealing with the "Goodness Grows" license plate fee distribution) is effective retroactively to August 2, 2000.* • *Sections 14 through 19, 21, 22, 29, and 30 (conforming changes necessitated by S.L. 2001-347) became effective January 1, 2002.*

Reallocate Clean Water Bond Funds

Session Law #	*Bill #*	*Sponsor*
S.L. 2001-416	**SB 247**	**Senator Kerr**

AN ACT TO REALLOCATE THE PROCEEDS OF THE CLEAN WATER BONDS AND TO DEFER THE ISSUANCE OF THE CLEAN WATER BONDS, NATURAL GAS BONDS, AND PUBLIC SCHOOL BUILDING BONDS UNTIL AFTER JANUARY 1, 2002.

OVERVIEW: This act does two things:

- It reallocates $71.4 million of Clean Water Bonds proceeds remaining in a loan program administered by DENR to related grant programs administered by the Rural Economic Development Center and for related administrative expenses. Converting loan funds to grant funds will reduce loan repayments that would have otherwise been credited to the General Fund.

- It provides that Clean Water Bonds, Natural Gas Bonds, and Public School Building Bonds cannot be issued during the period from September 1, 2001, until January 1, 2002. Delaying the issuance of the bonds until after January 1, 2002, moves their repayment costs into the 2002-03 fiscal year. The act provides that payments to local governments or payments to match federal funds that otherwise would have been made from the proceeds of Clean Water Bonds issued during the period September 1, 2001, and January 1, 2002, may be paid from General Fund cash balances.

FISCAL IMPACT: The act does not affect the first year of the biennium. It reduces General Fund revenue by $2.5 million in fiscal year 2002-03, $5.1 million in fiscal year 2003-04, $7.6 million in fiscal year 2004-05, and $7.5 million in fiscal year 2005-06. The Department of Natural and Economic Resources and the Rural Economic Development Center administer the loans and grants affected. The enactment of this act does not affect the budget requirements of either entity.

EFFECTIVE DATE: September 22, 2001.

ANALYSIS:

Reallocation of Clean Water Bond Proceeds

S.L. 1998-132, the Clean Water Bond Act, authorized the issuance of $800 million in Clean Water Bonds. The voters approved the bonds in November 1998. Of the $800 million, $300 million was designated for loans to local governments, administered by DENR, to be used for water supply systems, water conservation projects, water reuse projects, wastewater collection systems, and wastewater treatment works. Repayments of the loans are credited to the General Fund. The remaining $500 million of Clean Water Bond proceeds was allocated for various grant programs and to match federal wastewater or water assistance funds. S.L. 1998-132 provided that the $800 in Clean Water Bonds could be reallocated by the General Assembly between the various loan and grant programs designated in the act. S.L. 2000-156 withdrew $200 million of the $300 million loan funds and reallocated the funds for four grant programs that were established in the Clean Water Bonds Act: High Unit Cost grants administered by DENR and Unsewered Community, Supplemental, and Capacity grants, administered by the Rural Economic Development Center. The 2000 legislation also adjusted the annual caps on the amount of Supplemental and Capacity grants that can be issued each year.

This act shifts the remaining, uncommitted $71.4 million of the $300 million loan funds and reallocates the funds as follows:

- $35.6 million for Unsewered Community Grants. Unsewered Community Grants are grants administered by the Rural Economic Development Center for units of local government serving small, rural communities not served by centralized sewer systems for wastewater collection and treatment. These funds are expected to be granted over four years, with two grant cycles each year.
- $35.6 million for Supplemental Grants. Supplemental Grants are grants administered by the Rural Economic Development Center to help local governments match other grant or loan funds. The act also makes a conforming change to the annual cap on these Supplemental grants, so that the additional $35.6 will be granted over four years, with two grant cycles each year.
- $200,000 for administrative expenses of the Rural Economic Development Center in making grants of bond funds. The funds are remitted to the Center as soon as possible after July 1, 2001. The act requires the Rural Center to include with its annual reports

to the Joint Legislative Commission on Governmental Operations details on how these funds have been spent.

The Rural Center may change the allocation of funds between Unsewered Community grants and Supplemental grants if it determines that there has been a change in the relative needs for the two types of grants. The Rural Center must consult with the Joint Legislative Commission on Governmental Operations at least 30 days before making a reallocation. The act also requires the Rural Center to include in its annual report to the Commission a description of the criteria and point system it uses to award grants. The Rural Center must report to the Commission at least 60 days before changing the criteria or point system for awarding grants.

Defer Issuance of Certain Bonds

The act provides that no Clean Water Bonds, Natural Gas Bonds, or Public School Building Bonds may be issued before January 1, 2002. These bonds were scheduled to be issued in September 2001. The issuance of these bonds creates General Fund debt service requirements. The reallocation of some of the Clean Water Bonds from loans to grants, as authorized by this act, increases debt service on those bonds. Delaying issuance of the bonds until January 1, 2002, or a later date moves the fiscal impact of their issuance into the 2002-2003 fiscal year.

The act provides that payments to local governments or payments to match federal funds that otherwise would have been made from the proceeds of Clean Water Bonds issued during the period between September 1, 2001, and January 1, 2002, may be paid from General Fund cash balances. The Director of the Budget may not use more than $50,000,000 in General Fund cash balances for this purpose. The General Fund must be repaid from the Clean Water Bond proceeds after the Clean Water Bonds are issued for any costs covered with General Fund cash balances.

The Appropriations Act of 2001

Session Law	*Bill #*	*Sponsor*
S.L. 2001-424, as amended by S.L. 2001-476, 2001-497, and 2001-489	**SB 1005**	**Senator Plyler**

AN ACT TO MAKE BASE BUDGET APPROPRIATIONS FOR CURRENT OPERATIONS OF STATE DEPARTMENTS, INSTITUTIONS, AND AGENCIES, AND FOR OTHER PURPOSES.

OVERVIEW, FISCAL IMPACT, AND EFFECTIVE DATES:

Section #	*Description and Effective Dates*	*Fiscal Impact*
34.13	**Increase State Sales Tax** Increases the State sales tax by ½ cent for the period October 16, 2001 to July 1, 2003.	The General Fund revenue gain is as follows: FY 2001-02 $246.3 million FY 2002-03 $398.7 million FY 2003-04 $ 27.8 million

Section #	Description and Effective Dates	Fiscal Impact
34.14	**Local Option Sales Tax** Authorizes an additional ½ cent local sales tax effective July 1, 2003. This local option tax can be enacted by a special election or by a vote of the county commissioners. Effective July, 1, 2003, provides hold harmless payments to those local governments whose gain from a half cent local sales tax increase is less than 100% of their loss from the repealed state tax reimbursements.	If all 100 counties approve the ½ sales tax, the local revenue gain is as follows: FY 2003-04 $419.8 million FY 2004-05 $441.2 million FY 2005-06 $462.8 million Hold harmless payments begin in FY 2003-04 and have the following General Fund impact: FY 2003-04 -$23.3 million FY 2004-05 -$19.1 million FY 2005-06 -$15.6 million
34.15	**Local Government Reimbursements** Effective July 1, 2003, repeals the State reimbursement to local governments for property tax losses related to the repeal of taxes on inventories and intangibles, as well as some of the tax loss associated with the homestead exclusion. Also repealed is the reimbursement for sales taxes that are no longer paid on items purchased with food stamps.	This will produce a General Fund revenue gain of $333.4 million per year beginning in FY 2003-04.
34.16	**Sales Tax Holiday** Effective January 1, 2002, creates a Sales Tax Holiday -- a temporary, three-day sales tax exemption each August for clothing, sports and recreational equipment, school supplies, computers, printers, and educational software.	The provision produces the following General Fund revenue loss: FY 2002-03 -$8.4 million FY 2003-04 -$7.7 million FY 2004-05 -$8.1 million FY 2005-06 -$8.4 million And the following local government revenue loss: FY 2002-03 -$3.7 million FY 2004-05 -$4.9 million FY 2005-06 -$5.1 million

Section #	Description and Effective Dates	Fiscal Impact
34.17	**Equalize Taxation of Satellite TV and Cable TV** Effective January 1, 2002, imposes a 5% State tax on the gross receipts derived from providing direct-to-home satellite TV service to subscribers.	The tax will generate the following General Fund revenue gain: FY 2002-03 $9.8 million FY 2003-04 $21.7 million FY 2004-05 $24.1 million FY 2005-06 $25.3 million
34.18	**New Income Tax Bracket** Effective for taxable years beginning on or after January 1, 2001, and expiring for taxable years beginning on or after January 1, 2004. Creates new 8.25% tax bracket for taxable incomes over the following amounts: $200,000 Married filing jointly $160,000 Head of household $120,000 Single $100,000 Married filing separately	The new rate is estimated to affect 9,848 single filers, 52,463 married couples, and 1,148 heads of households. The General Fund revenue gain is as follows: FY 2001-02 $125.5 million FY 2002-03 $102.9 million FY 2003-04 $61.6 million
34.19	**Eliminate Marriage Tax Penalty for Standard Deduction** Changes standard deduction for married filing jointly taxpayers from $5,000 to $5,500 in tax year 2002 and then to $6,000 in tax year 2003.	It is estimated that this change will benefit 762,340 couples in tax year 2002. The General Fund revenue loss is as follows: FY 2001-02 $9.7 million FY 2002-03 $32.0 million FY 2003-04 $45.0 million FY 2004-05 $45.8 million FY 2005-06 $46.5 million

Section #	Description and Effective Dates	Fiscal Impact
34.20	**Increase Tax Credit for Children** Increases the tax credit for children from $60 to $75 per child in tax year 2002 and then to $100 in tax year 2003.	It is estimated that this change will benefit 18,354 single tax filers, 496,286 married couples, and 411,648 heads of households. The General Fund revenue loss is as follows: FY 2002-03 -$19.8 million FY 2003-04 -$54.8 million FY 2004-05 -$55.0 million FY 2005-06 -$55.3 million
34.21	**Eliminate Children's Health Insurance Credit** Repeals the Children's Health Insurance Credit effective for tax year 2001.	In 1999, 117,972 taxpayers filed for $18.9 million in Child Health Insurance credits. $18.9 million is used as the General Fund revenue gain each year from repeal of the credit.
34.22	**Equalize Taxation of HMOs and Medical Service Companies** Taxes the gross premiums of HMOs and Medical Service Companies (Blue Cross/Blue Shield and Delta Dental) at 1.1% in 2003 and at 1% for every year thereafter, as amended by S.L. 2001-489.	The General Fund revenue gain is as follows: FY 2002-03 $28.2 million FY 2003-04 $30.6 million FY 2004-05 $33.2 million FY 2005-06 $35.9 million

Section #	Description and Effective Dates	Fiscal Impact
34.23	**Spirituous Liquor Sales Tax and Excise Tax** Imposes a 6% State sales tax on spirituous liquor effective December 1, 2001. Reduces the excise tax on spirituous liquor sold in ABC stores from 28% to 25% effective February 1, 2002.	The tax will be collected on retail sales at 392 Alcoholic Beverage Control (ABC) Commission stores in the State. Actual liquor sales in FY 1999-00 were $367.7 million and are anticipated to increase 3.82% per year. The following General Fund revenue gain is expected: FY 2001-02 $11.9 million FY 2002-03 $24.7 million FY 2003-04 $25.6 million FY 2004-05 $26.6 million FY 2005-06 $27.6 million The General Fund revenue loss is as follows: FY 2001-02 -$3.5 million FY 2002-03 -$10.9 million FY 2003-04 -$11.4 million FY 2004-05 -$12.0 million FY 2005-06 -$12.6 million

Section #	Description and Effective Dates	Fiscal Impact
34.24	**No Tax Break for Luxury Cars** Deletes the $1,500 cap on the 3% Highway Use Tax for non-commercial vehicles effective October 1, 2001. Also exempts from the Highway Use Tax all fire trucks and rescue vehicles purchased by volunteer fire departments and rescue squads. S.L. 2001-489 provided that the repeal of the $1,500 highway use tax cap did not apply to vehicle titles issued pursuant to a sale or a contract entered into before October 1, 2001. S.L. 2001-497 restored the $1,500 highway use tax cap for recreational vehicles that do not qualify as commercial vehicles, effective retroactively as of October 1, 2001.	The net revenue gained from these changes will be transferred from the Highway Trust Fund to the General Fund in the following amounts: FY 2001-02 $1.7 million FY 2002-03 $2.4 million FY 2003-04 $2.6 million FY 2004-05 $2.7 million FY 2005-06 $2.9 million The amendments in S.L. 2001-489 and S.L. 2001-497 did not reduce the amounts transferred to the General Fund from the Highway Trust Fund. Therefore, the cost of restoring the cap on recreational vehicles will be borne by the Highway Trust Fund. The loss to the Highway Trust Fund for FY 2001-02 is expected to be $632,000 and $909,000 for FY 2002-03.
34.25	**Uniform Telecommunications Tax at 6%** Effective January 1, 2002.	See Summary of S.L. 2001-430.

ANALYSIS:

INCREASE STATE SALES TAX BY ONE-HALF CENT UNTIL JULY 1, 2003

Section 34.13 increases the State sales tax from 4% to 4.5%, effective October 16, 2001. The tax increase is repealed July 1, 2003. The State sales tax rate was last increased in 1991 from 3% to 4%.

LOCAL OPTION SALES TAX/ HOLD HARMLESS

Sec. 34.14 authorizes all counties of the State to levy a one-half cent sales tax. Like the State sales tax, this new tax would not apply to food. As with the existing statewide local options sales taxes, the county could choose to levy the tax by resolution after 10 days' public notice and a public hearing, or could choose to submit the question to the voters in a special election held after 30 days' public notice. The earliest the new tax could become effective in a county is July 1, 2003.

The net proceeds of the tax would first be allocated among the counties. One-half would be allocated on a point-of-origin basis and one-half would be allocated on a per capita basis. Each county's allocation would then be divided between the county and the municipalities in the county using the same formula by which the existing local sales taxes are divided in that county.

As with the existing local sales taxes, the State's costs of collecting and administering the new tax come from the local tax proceeds.

Sec. 34.14 also provides an annual hold-harmless distribution from the State's General Fund to counties and cities to ensure that none of them would lose money when the local government reimbursements repealed in Sec. 34.15 of the act are netted against the estimated proceeds of the sales tax if it were levied in each county as of July 1, 2003. The hold-harmless distribution provides that if a county's or city's estimated proceeds of a half-cent tax would be less than 100% of the amount it would have gotten under the repealed reimbursements, it will receive reimbursement for the difference. If a county's or city's estimated gain from the half-cent tax exceeds 100% of its repealed reimbursement amount, it does not receive a hold-harmless payment from the State. The hold-harmless payment is the same whether or not the new tax is levied in the county. The Department of Revenue will make the hold-harmless distribution annually, drawing the funds from State sales tax collections. The hold-harmless payments must be made by September 15 of each year, beginning in 2003.

LOCAL GOVERNMENT REIMBURSEMENTS

Section 34.15 repeals all of the State's reimbursement payments to local governments, effective beginning with the 2003-2004 fiscal year. State reimbursements are amounts distributed to local units to compensate them for revenue lost as a result of the removal by the General Assembly of property from the local sales and use tax base, the local property tax base, or the intangibles tax base. State reimbursements consist of reimbursements for the repeal of the property tax on inventories and on poultry and livestock, the repeal of the intangibles tax, the "homestead exclusion" from property tax, and the repeal of local sales and use taxes on food purchased with food stamps.

SALES TAX HOLIDAY

Section 34.16 provides that certain purchases made during the first weekend in August of each year are exempt from the State and local sales and use tax, beginning in August 2002.[35] The exempt purchases include the following:

- Clothing with a sales price of $100 or less per item.
- School supplies with a sales price of $100 or less per item.
- Computers, printers and printer supplies, and education computer software with a sales price of $3,500 or less per item. The term "computer" means a central processing unit and any peripherals sold with it and any computer software installed at the time of purchase.
- Sport or recreational equipment with a sales price of $50 or less per item.

Exclusions from the list of exemptions include:

- Clothing accessories or equipment. Clothing accessories are defined as "incidental items worn on the person or in conjunction with clothing including jewelry, cosmetics, eyewear, wallets, and watches.
- Protective equipment.

[35] S.L. 2001-476 excluded "clothing accessories" and "protective equipment" from the Sales Tax Holiday, included "sports and recreation equipment" in the Sales Tax Holiday, incorporated definitions from the Streamlines Sales Tax Project, and made other technical and conforming changes.

- Furniture
- Items on layaway.
- Items used in trade or business
- Rentals.

New York became the first state to enact a sales tax holiday in 1996. By 2000, Florida, Texas, Iowa, Maryland, Connecticut, Pennsylvania, and South Carolina had enacted sales tax holidays. Oklahoma enacted a sales tax holiday in 2001. The District of Columbia held two sales tax holiday in 2001; one in August and one in late November and early December. The period of time during which certain purchases are exempt from sales and use tax varies from state to state, as do the purchases that are exempt.

EQUALIZE TAXATION OF SATELLITE TV AND CABLE TV

Section 34.17 establishes a 5% State sales tax on the gross receipts derived from providing satellite TV services, effective January 1, 2002. The gross receipts are not subject to the local 2% sales tax. Currently, cable TV may be subject to a local franchise tax of up to 5%. Satellite TV is not subject to a local franchise tax. This part of the act equalizes the tax treatment between satellite TV and cable TV by providing that both are subject to a 5% tax on their gross receipts. The equalization of the taxation of cable TV and satellite TV was part of the Governor's recommended tax loophole closings.

The State's taxation of entertainment varies depending upon the type of entertainment. This section begins taxing two similar types of entertainment at the same rate. However, other forms of entertainment will continue to be taxed differently. For example, live entertainment is subject to a 3% gross receipts tax while movies are subject to a 1% gross receipts tax and video rentals are subject to a 6.5% State and local sales tax.

NEW TAX BRACKET FOR INCOME OVER $200,000

Section 34.18 adds a new tax bracket that imposes an additional ½ % income tax on certain North Carolina taxable income for three years. Under prior North Carolina law, tax was imposed at the following rates on individuals' North Carolina taxable income (NCTI):

Tax Rate	*NCTI married filing jointly*	*NCTI heads of household*	*NCTI unmarried individuals*	*NCTI married filing separately*
6.0%	Up to $21,250	Up to $17,000	Up to $12,750	Up to $10,625
7.0%	Over $21,250 and up to $100,000	Over $17,000 and up to $80,000	Over $12,750 and up to $60,000	Over $10,625 and up to $50,000
7.75%	Over $100,000	Over $80,000	Over $60,000	Over $50,000

This section creates a fourth tax bracket with a marginal tax rate of 8.25% on taxable income over $200,000 for married couples filing jointly, over $160,000 for heads of household, over $120,000 for unmarried individuals, and over $100,000 for married individuals filing separately. This change will affect approximately 2% of North Carolina taxpayers. The new bracket will be in effect only for the 2001, 2002, and 2003 tax years.

As of the end of the 1999 tax year, 43 states imposed a tax on individual income. Up to ten states had a marginal rate of tax that equals or exceeds 8.5%.[36] None of these states are located in the Southeast. The highest marginal tax rates on individual income in the four states that border North Carolina ranged from 5.75% to 7% in 1999.

ELIMINATE THE MARRIAGE TAX PENALTY FOR THE STANDARD DEDUCTION

Section 34.19 will reduce North Carolina income taxes on married couples who claim the standard deduction by increasing the amount of the standard deduction.[37] Since 1989, the basic standard deduction for a single person in North Carolina has been $3,000 while that for a married couple filing jointly has been $5,000. Section 34.19 of this act increases the standard deduction for married couples from $5,000 to $6,000, so that it will be twice that of a single taxpayer. The increase in the deduction is phased in over the 2002 and 2003 tax years. The standard deduction for married persons filing separately is one-half that for a married couple filing jointly, so this act phases it up from $2,500 to $3,000 over the 2002 and 2003 tax years.

The so-called marriage tax penalty is the result of a tax system that recognizes that a married couple's living expenses are less than the expenses of two single people living separately but more than the expenses of one single person. In addition, if one spouse is not employed full-time, a married couple's income would be less than that of two comparable single people who work full-time, but more than that of one single person. The tax law addresses these situations through the tax brackets, the personal exemptions, and the standard deduction. The result of these tax provisions is that a married couple with only one spouse working experiences a tax reduction when they marry, a married couple where one spouse earns substantially more than the other experiences no tax reduction or increase when they marry, and a married couple with both spouses earning roughly the same amount experiences a tax increase when they marry.

INCREASE TAX CREDIT FOR CHILDREN

The 1995 General Assembly enacted a tax credit of $60 per child for taxpayers who have dependent children and have family adjusted gross income below $100,000 for a married couple and $80,000 for a head of household. Section 34.20 increases the tax credit to $75 for the 2002 tax year and $100 for the 2003 tax year.

The credit is in addition to the federal and state tax credits or exclusions for child care expenses. The credit is allowed for each dependent child for whom the eligible taxpayer could take a federal personal exemption under section 151(c)(1)(B) of the Internal Revenue Code. That Code section allows an exemption for each dependent child who either is less than 19 years old at the end of the taxable year or is a student and is less than 24 years old at the end of the taxable year. A child is a son, stepson, daughter, or stepdaughter. A dependent child is a child over half of whose support was provided by the taxpayer.

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[36] California (9.3%), the District of Columbia (9.5%), Hawaii (8.75%), Iowa (8.98%), Maine (8.5%), and Montana (11%) all had marginal rates that equaled or exceeded 8.5%. Massachusetts had three flat rates of taxation that are applied to different sources of income. One of these rates is 12%. North Dakota had a marginal rate of 12%, though most taxpayers use an alternate calculation based on federal tax liability (14% of federal tax liability). Finally, Rhode Island and Vermont had an income tax calculated as a percentage of federal tax liability (26.5% for RI and 25% for VT). In 1999, the highest federal marginal tax rate was 39.6%.

[37] Roughly 70% of North Carolina taxpayers claim the standard deduction.

ELIMINATE THE CHILDREN'S HEALTH INSURANCE CREDIT

In 1998, the General Assembly enacted a refundable individual income tax credit for certain taxpayers who purchase health insurance for their dependent children. The credit was equal to the amount of premiums paid, up to $300 for those taxpayers with incomes below 225% of the Federal Poverty Level and up to $100 for those taxpayers above the 225% threshold. Taxpayers who had their health insurance premiums deducted from their income before it is taxed did not qualify for the credit. Taxpayers whose adjusted gross income was higher than $100,000 (joint return) did not qualify for the credit.

Governor Hunt convened the General Assembly in an extra session beginning March 24, 1998, to address the issue of uninsured children. In 1998, there were more than 71,000 uninsured children in North Carolina whose parents made too much money to qualify for Medicaid but who could not afford to purchase health insurance for their children. Under Title XXI of the Social Security Act, North Carolina had the opportunity to receive $79.9 million in federal money in order to provide health care for children if the State established a Health Insurance Program for Children that met federal guidelines.

The 1998 legislation established a Health Insurance Program for Children. To be eligible for the program, the person must be ineligible for other government-sponsored health insurance, be under the age of 19 and enrolled in school, be uninsured for six months prior to application, be in a family that meets the income requirements, be a State resident, and pay the required premium amount. The premium amounts vary depending upon the family's income from zero to $5 per child per month with a $15 per month family unit cap to $10 per child per month with a $28 per month family unit cap. A family who loses coverage under the Program due to an increase in income may purchase extended coverage through the Program for one year by paying the full premium costs.

In addition to creating a Health Insurance Program for Children, the General Assembly enacted a tax credit for taxpayers who purchase health insurance for their children to help bridge the gap between assisted health insurance costs under the Heath Insurance Program and unassisted health insurance costs as a family begins earning too much income to qualify for the Program. The credit was not allowed for the reduced premiums paid under the Program; it was allowed for premiums paid to purchase extended coverage under the Program. Section 34.21 repeals this credit, effective for taxable years beginning on or after January 1, 2001.

EQUALIZE TAXATION OF HMOs AND MEDICAL SERVICE COMPANIES

Section 34.22 imposes a uniform gross premiums tax on Health Maintenance Organizations and on Article 65 corporations. As amended by S.L. 2001-489, the tax rate is 1.1% for taxable years beginning on or after January 1, 2003 and 1% for taxable years beginning on or after January 1, 2004.[38]

Under current law, Article 65 corporations, such as Blue Cross/Blue Shield and Delta Dental Corporation, pay a gross premiums tax of 0.5%. HMOs do not pay a gross premiums tax; however, they are subject to the State's corporate income and franchise tax levies. Other insurance providers pay a gross premiums tax of 1.9%. Companies that pay a gross premiums tax are automatically exempt from corporate income and franchise taxes.

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[38] Originally, the tax rate would have been 0.833% for the 2002 tax year and 1% for taxable years beginning on or after January 1, 2003. The General Assembly modified the tax rates at the request of the HMO and medical service corporation industry because they had already sent their customers rate notices for the 2002 tax year that did not include the 0.83% rate for the 2002 tax year.

This section subjects all insurance carriers to the gross premiums tax in lieu of the State's corporate income and franchise taxes. All 50 states impose a gross premiums tax on insurance companies; 23 states extend the tax to HMOs. The extension of the tax base to include gross premiums on insurance contracts issued by HMOs was part of the Governor's recommended tax loophole closings.

SPIRITUOUS LIQUOR SALES TAX AND EXCISE TAX

Section 34.23 imposes a 6% sales tax on spirituous liquor, effective December 1, 2001, and reduces the excise tax on spirituous liquor from 28% to 25%, effective February 1, 2002. Under prior law, mixed beverages were subject to sales tax but spirituous liquor (liquor sold in ABC stores) was exempt. The statute levying the 28% excise tax on liquor sold in ABC stores stated that the excise tax was in lieu of sales tax.

This section repeals the sales tax exemption for spirituous liquor and provides that liquor sold in ABC stores is subject to a 6% State sales tax, effective December 1, 2001. If the liquor is sold to a mixed beverage permittee or guest room cabinet permittee for resale, the permittee may apply for a certificate of resale under existing law and not be subject to the sales tax. Mixed beverages will continue to be subject to sales tax at a combined State and local rate of 6.5%.

Spirituous liquor and mixed beverages are defined in the ABC law as follows:

- "Spirituous liquor" or "liquor" means distilled spirits or ethyl alcohol, including spirits of wine, whiskey, rum, brandy, gin and all other distilled spirits and mixtures of cordials, liqueur, and premixed cocktails, in closed containers for beverage use regardless of their dilution.
- "Mixed beverage" means either of the following:
    a. A drink composed in whole or in part of spirituous liquor and served in a quantity less than the quantity contained in a closed package.
    b. A premixed cocktail served from a closed package containing only one serving.

The 28% (reduced in this act to 25%) excise tax levied on liquor sold in ABC stores is levied on the price of liquor calculated as the sum of the following components:

- The distiller's price.
- The State ABC warehouse freight and bailment charges.
- A markup for local ABC boards.

NO TAX BREAK FOR LUXURY CARS/NO FIRE & RESCUE VEHICLE TAX

Section 34.24 deletes the $1,500 cap on the 3% highway use tax on all non-commercial vehicles except recreational vehicles.[39] It also exempts from the highway use tax fire trucks and rescue vehicles owned by volunteer fire departments and volunteer rescue squads. To qualify for the exemption, the volunteer fire department or rescue squad must not be a part of a unit of local government, must have no more than two paid employees, and must be exempt from State

[39] This act removed the $1,500 cap on all non-commercial vehicles. S.L. 2001-497 (House Bill 72) reinstated the $1,500 cap for recreational vehicles that are not subject to the $1,000 cap. A recreational vehicle is defined as "a motorized or towable vehicle that combines transportation and temporary living quarters for travel, recreation, and camping."

income tax under G.S. 105-130.11. The vehicles that may be exempt from the tax are: an emergency services vehicle, a fire truck, a pump truck, a tanker truck, a ladder truck used to suppress fire, and a four-wheel drive vehicle intended to be mounted with a water tank and hose and used for forest fire fighting. An ambulance is not a Class A or B commercial vehicle and so would be subject to the full 3% tax if it were not exempted by this section. The remaining fire and rescue vehicles would be considered Class A or Class B commercial vehicles and would be subject to the $1,000 maximum highway use tax if not exempted by this act.

These changes became effective for certificates of title issued on or after October 1, 2001.[40] The estimated net revenue gain from these two tax changes will be credited from the Highway Trust Fund to the General Fund each year on July 1. This transfer reflects the fact that before 1989, sales tax on motor vehicles was a General Fund revenue source.

The General Assembly enacted the highway use tax in 1989 as a revenue source for the Highway Trust Fund. The highway use tax is payable when a certificate of title is issued for a motor vehicle. The tax is 3% of the retail value of a motor vehicle, formerly subject to a maximum tax of $1,500 for automobiles and other vehicles that weigh no more than 26,000 pounds and a maximum tax of $1,000 for Class A or Class B commercial vehicles that weigh more than 26,000 pounds. In general, the commercial vehicles subject to the $1,000 maximum tax are truck tractors and large trucks and, to drive them, a person must have the appropriate class of commercial driver's license. The maximum tax of $1,500 on all other motor vehicles meant that a vehicle valued at an amount over $50,000 did not pay the highway use tax at a full 3% rate because the cap was reached once the vehicle's value reached $50,000. The highway use tax is in addition to the $35.00 fee that is charged for the issuance of a title and the $10.00 or $20.00 fee that is charged for the transfer or issuance of a license plate.

The highway use tax replaced the former sales tax on motor vehicles. Sales tax revenue is credited to the General Fund. Revenue from the highway use tax is credited to the Highway Trust Fund. Each year, $170 million is transferred from the Highway Trust Fund to the General Fund. This amount was chosen by the General Assembly in 1989 because it was the amount of sales tax revenue the General Fund received from the sale of motor vehicles before the repeal of the sales tax on motor vehicles.

PROVIDE UNIFORM TAXATION OF TELECOMMUNICATIONS AT 6%

S.L. 2001-430 established one tax at one rate for all telecommunications services. The rate set in that act is 4.5%. Section 34.25 of this act changes the rate from 4.5% to 6% effective January 1, 2002. Under prior law, local telecommunications were subject to a 3.22% gross receipts franchise tax and a 3% sales tax, intrastate long distance was subject to a 6.5% sales tax, and interstate long distance was not taxed at all. Under S.L. 2001-430, all telecommunication services are subject to a State sales tax at a uniform rate.[41]

Budget Revenue Provisions

Session Law #	*Bill #*	*Sponsor*

[40] This effective date was amended by S.L. 2001-489 (House Bill 748) so that it did not apply to certificates of title issued as a result of a purchase made before October 1, 2001, or made pursuant to a contract entered into or awarded before October 1, 2001.

[41] For further discussion of changes to taxation of telecommunications, see the summary of S.L. 2001-430 – Simplify Taxes on Telecommunications.

S.L. 2001-427	HB 232	Representative Allen

AN ACT TO SET THE INSURANCE REGULATORY CHARGE, THE PUBLIC UTILITY REGULATORY FEE, AND THE ELECTRIC MEMBERSHIP CORPORATION REGULATORY FEE; INCREASE THE NONRESIDENT FEE FOR SEARCHING PUBLIC ARCHIVES; UPDATE THE REFERENCE TO THE INTERNAL REVENUE CODE; ACCELERATE PAYMENT OF WITHHOLDING TAXES; ACCELERATE PAYMENT OF SALES AND UTILITY TAXES; AUTHORIZE CERTAIN COUNTIES TO ACQUIRE PROPERTY FOR PUBLIC SCHOOLS; PROVIDE GENERAL ASSEMBLY OVERSIGHT OF AGENCY FEES; EXEMPT FROM FUEL TAX FUEL USED BY COMMUNITY COLLEGES; MAKE CLARIFYING CHANGES IN THE SUBSIDIARY DIVIDEND PROVISIONS; AUTHORIZE THE COMMISSIONER OF LABOR TO ESTABLISH CERTAIN FEES; MAKE TECHNICAL AND CLARIFYING CHANGES TO THE FRANCHISE TAX; ACCELERATE PAYMENT OF LOCAL SALES AND USE TAX REVENUE TO LOCAL GOVERNMENTS; AND ACCELERATE PAYMENT OF THE REVENUE GENERATED BY THE STATE EXCISE TAX ON CONVEYANCES TO THE STATE AND EXEMPT PRISONS LOCATED ON LAND OWNED BY THE STATE AND BUILT PURSUANT TO A CONTRACT WITH THE STATE FROM PROPERTY TAX.

OVERVIEW: This act contains the following fee and budget-related items:

- Sets the insurance regulatory charge at 6.5% for the 2001 calendar year.
- Sets the utilities regulatory fee at 0.1% for the 2001-2002 tax year and the public utility regulatory fee imposed on electric membership corporations at $200,000.
- Increases the nonresident search fee from $10 to $25.
- Updates the reference to the Internal Revenue Code from January 1, 2000, to January 1, 2001.
- Accelerates the payment of withholding taxes.
- Accelerates the payment of sales and utility taxes.
- Authorizes Bertie, Chatham, Clay, Rutherford, Transylvania, and Yadkin Counties to use certificates of participation to acquire property for public schools.
- Provides that agencies may not establish or increase a fee without consulting with the Joint Legislative Commission on Governmental Operations.
- Exempts community colleges from paying the motor fuels tax.
- Clarifies that foreign source dividends are treated the same for State income tax purposes as domestic source dividends.
- Authorizes the Commissioner of Labor to establish elevator and amusement device inspection fees.
- Makes a technical and clarifying change to the franchise tax statute.
- Accelerates distribution of local sales and use tax revenue to local governments.
- Accelerates payment of the revenue generated by the State excise tax on conveyances to the State.

- Exempts prisons located on land owned by the State and built pursuant to a contract with the State from property tax.

ANALYSIS, EFFECTIVE DATE, AND FISCAL IMPACT: The following is a section-by-section summary of the act, setting out the analysis, effective date, and fiscal impact of each section:

Insurance Regulatory Charge (Section 1)

This section reduces the insurance regulatory charge from 7% to 6.5% for the 2001 calendar year. This fee is assessed on the premiums tax paid by insurers. The charge is expected to generate $23.82 million for the 2001-2002 fiscal year. This Section became effective September 28, 2001.

Regulatory Fee for Utilities Commission (Section 2(a))

This section sets the tax rate for the public utility regulatory fee for the 2001-2002 tax year at 0.1%. This rate must be set by the General Assembly each year. This rate is slightly higher than the 0.09% rate in effect 2000-2001 fiscal year. Increasing this fee for fiscal year 2001-02 to fund the operations of the Utilities Commission and the Public Staff is expected to produce $10.5 million in fiscal year 2001-02. This Section became effective July 1, 2001.

North Carolina Electric Membership Corporation Fee (Section 2(b))

The section sets at $200,000 the annual public utility regulatory fee imposed on electric membership corporations whose principal purpose is to furnish or cause to be furnished bulk electric supplies at wholesale, as provided in G.S. 117-16. This is the same rate that was in effect for the 2000-2001 fiscal year. The North Carolina Electric Membership Corporation is the only electric membership corporation that fits this description. The proceeds of the fee will be credited to the Utilities Commission and Public Staff Fund and used to defray the State's cost in regulating electric membership corporations. This Section became effective July 1, 2001.

Increase Nonresident Search Fee (Section 3)

This section allows the Department of Cultural Resources to increase the fee cap from $10 to $25 for searches of archived public records pursuant to a written request by a nonresident. The increased fee will generate approximately $50,000 to $60,000 each year. This Section became effective January 1, 2002.

Update Internal Revenue Code Reference (Section 4)

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

Four Congressional bills were enacted in calendar year 2000 that have an impact on State individual and corporate income tax law. Public Law 106-230 requires organizations to disclose political activities. Public Law 106-554 makes changes in low income housing tax credits, HUD renewal communities, HUD empowerment zones, brownfield remediation, corporate computer donations, and medical savings accounts. Public Law 106-573 reverses

a prohibition of using accrual method in reporting income. Public Law 106-591 repeals foreign sales corporations. The estimated General Fund impact is as follows:

FY 2001-02	- $3.37 million
FY 2002-03	- $3.82 million
FY 2003-04	- $3.40 million
FY 2004-05	- $3.59 million
FY 2005-06	- $5.13 million

Accelerate Payment of Withholding Taxes (Section 5)

Under prior law, those employers liable for less than $500 a month in employee wage withholding were given the option to pay quarterly. Subsections (a) and (b) of Section 5 change the $500 threshold to $250, so that those employers liable for $250 to $500 a month will pay monthly but employers liable for less than $250 a month may still choose to pay quarterly. These subsections became effective January 1, 2002, and apply to payments of withheld income taxes made on or after that date. The Secretary of Revenue is required to review the thresholds for the accelerated payment of withheld taxes to evaluate the efficiency, burden, and level of compliance and to report the findings to the Revenue Laws Study Committee. The estimated General Fund impact is as follows:

FY 2001-02	$57.12 million (nonrecurring.) $ .88 million (recurring)
FY 2002-03	$ 1.85 million
FY 2003-04	$ 2.00 million
FY 2004-05	$ 2.16 million
FY 2005-06	$ 2.33 million

Accelerate Payment of Sales and Utility Taxes (Section 6)

This Section increases the number of taxpayers required to submit semimonthly sales tax payments and accelerates the payment schedules for the sales tax on telecommunications and electricity and for the excise tax on piped natural gas:

- Subsection (a) changes the threshold for paying sales taxes semimonthly from $20,000 a month to $10,000 a month. Subsection (b) allows the Secretary to require sales tax returns to be filed electronically Semimonthly payers are required to pay by electronic funds transfer. The returns would continue to be due monthly. The estimated General Fund impact is as follows:

FY 2001-02	$9.72 million (nonrecurring) $ .21 million (recurring)
FY 2002-03	$ .45 million
FY 2003-04	$ .48 million
FY 2004-05	$ .50 million
FY 2005-06	$ .52 million

- Subsections (c) and (e) make the payment schedule for electricity and telephone sales taxes the same as regular sales taxes.[42] This requires some of the state's largest utilities to shift from monthly to semimonthly payments of sales taxes owed on electricity and telephone. The estimated General Fund impact is as follows:

FY 2001-02	$15.3 million	(nonrecurring)
	$ .85 million	(recurring)
FY 2002-03	$ 1.77 million	
FY 2003-04	$ 1.84 million	
FY 2004-05	$ 1.91 million	
FY 2005-06	$ 1.99 million	

- Subsection (f) requires piped gas excise taxes to be paid on a semimonthly schedule rather then the current monthly schedule. The estimated General Fund impact is as follows:

FY 2001-02	$14.5 million	(nonrecurring)
FY 2002-03	$ 1.87 million	
FY 2003-04	$ 1.95 million	
FY 2004-05	$ 2.02 million	
FY 2005-06	$ 2.11 million	

- Subsection (g) requires the Secretary to review the thresholds in G.S. 105-163.6 for accelerated payment of withheld taxes to evaluate the efficiency, burden, and level of compliance. The Secretary is also required to take steps to assure taxpayer compliance and report to the Revenue Laws Study Committee by April 1, 2002. This review and enforcement action were necessitated because some employers who are required to remit State income taxes on an accelerated basis (within 3 days after the payroll date) are continuing to send the money in monthly. The estimated General Fund impact from enforcement of the accelerated payment is $12.6 million for FY 2001-02. This is a one-time revenue gain. Subsection (h) authorizes the Revenue Laws Study Committee to study the reporting requirements for electric power companies and the method by which the franchise tax on these companies is distributed to cities to determine simpler ways to achieve the goals of the current requirements and distribution method.

Section 6 became effective January 1, 2002.

Certificates of Participation (COPSs) for Certain Counties (Section 7)

This Section adds Bertie, Chatham, Clay, Rutherford, Transylvania, and Yadkin Counties to the list of counties authorized to acquire school property on behalf of their boards of education. The 2001 General Assembly earlier enacted S.L. 2001-76 granting this authority to Anson, Craven, McDowell, Montgomery, and Pamlico Counties. Eighty-one counties currently have this

[42] Section 6.(e) of the act was repealed in S.L. 2001-487, because the franchise tax on telecommunications was replaced with a uniform gross receipts sales tax in S.L. 2001-430. However, under the act, as amended, the payment schedule for telephone sales taxes will still be the same as regular sales taxes. G.S. 105-164.16, as amended in Section 6 (a) of the act, sets out the general rule for payment of sales and use taxes, and this general rule now includes sales and use taxes on utilities.

authority. This Section became effective September 1, 2001. No General Fund Impact is expected.

General Assembly Oversight of Agency Fees (Section 8)

This Section provides that an agency may not establish or increase a fee or charge unless one of the following conditions has been met:

- The General Assembly has set the fee or charge amount and the purpose of that fee or charge by statute.
- The General Assembly has given the agency general authority to establish or increase a fee or charge by statute and the agency has consulted with the Joint Legislative Commission on Governmental Operations before establishing or increasing that fee or charge.

This section became effective September 1, 2001.

Community College Fuel Tax Exemption (Section 9)

This Section exempts community colleges from paying the motor fuels tax, effective January 1, 2002. Allowing community colleges to buy non-tax paid fuel directly from suppliers will decrease revenues in the Highway Fund and Highway Trust Fund by approximately $50,000 a year.

Clarifying Changes in the Subsidiary Dividend Provisions (Section 10)

This Section amends S.L. 2001-327 to clarify that foreign source dividends are treated the same for State income tax purposes as domestic source dividends. Under S.L. 2001-327, North Carolina piggybacks the federal dividends received deduction for State corporate income tax purposes. This deduction pertains to dividends of domestic (US) corporations. The federal deduction is a gross deduction, but under G.S. 105-130.5(c)(3) the expenses are required to be netted.

To equalize the tax treatment of domestic and foreign source dividends, S.L. 2001-327 provided in G.S. 105-130.5(b) that dividends of foreign corporations could also be deducted from taxable income to the extent they are included in federal taxable income. Because the deduction for foreign source dividends is contained in G.S. 105-130.5(b), the provision in G.S. 105-130.5(c)(3) requiring that the expenses be netted does not apply. This Section clarifies that the dividends of domestic and foreign source dividends are to be taxed the same by providing that the deduction for foreign source dividends is also net of related expenses. This Section became effective for taxable years beginning on or after January 1, 2001. There is no fiscal impact.

Labor Commissioner Fee Authority (Section 11)

Subsection (c) of this Section gives the Commissioner of Labor the authority to set the fees for the inspection and issuance of certificates of operation for the devices in Subsections (e) and (f) of this Section. This fee-setting ability will put the Department of Labor in a position to make its Elevator and Amusement Device Division fee-supported. Under prior law, these fee amounts were specifically set by statute and varied based upon factors such as the cost of the installation or alteration, the number of building floors, and the type of amusement device. Subsection (c) became effective September 28, 2001.

Subsection (e) of this Section provides in G.S. 95-110.5(20) that the fee for inspecting elevators, dumbwaiters, escalators, moving walks, personnel hoists, stairway chair lifts, wheelchairs lifts,

manlifts, and special equipment may not exceed $200. Subsection (e) became effective September 28, 2001.

Subsection (f) of this Section provides in G.S. 95-111.4(19) that the fee for inspecting amusement devices may not exceed $250. Subsection (f) became effective September 28, 2001.

Subsection (d) of this Section specifies that all fees collected under G.S. 95-111.4may be used only for inspection and certification purposes. Subsection (d) became effective September 28, 2001.

To establish the fees in G.S. 95-110.5(20) and G.s. 95-111.4(19), the Commissioner must go through the rule-making process. Under the administrative procedure act, a recent act of the General Assembly authorizes the agency to adopt temporary rules. The adoption of a temporary rule establishing the fee amounts is subject to the requirements of Section 8 of this act.[43]

Subsection (a) of this section repeals the current statutory fee amounts when the rules establishing the fee amounts in Subsections (e) and (f) become effective.

The fees proposed by the Commissioner of Labor will yield an additional $1 million in FY 2001-02 and $1.6 million in 2002-03.

Technical and Clarifying Changes to the Franchise Tax (Section 12)

In 1996, the General Assembly repealed the corporate income tax credit for qualified business investments, effective for investments made on or after January 1, 1997, because it was advised by the Attorney General's Office that the credit unconstitutionally favored businesses headquartered and operating in North Carolina. Prior to its repeal, the corporate income tax credit could have been claimed against the franchise tax and a reference to this credit was in the franchise tax law. When the corporate credit was repealed, a conforming change to the franchise tax statute was not made. The act makes this conforming change. It also adds standard language to the remaining credit referenced in G.S. 105-122(d1)[44] clarifying that the credit is not a refundable tax credit. Section 12 became effective September 28, 2001.

Accelerate Payment of Local Sales and Use Tax Revenues (Section 13)

The local governments have a 2% sales and use tax rate. Unlike other local taxes, this local tax is collected by the State and distributed to the counties and municipalities quarterly.

Section 13 provides that the distribution must be made monthly, effective July 1, 2003. The State's loss of interest on these funds will be as follows:

FY 2003-04	- $9.6 million
FY 2004-05	- $10.1 million
FY 2005-06	- $10.6 million

[43] Section 8 of the act provides that an agency must consult with the Joint Commission on Governmental Operations before a rule establishing or increasing a fee amount may become effective.

[44] A corporation may claim a credit against its franchise tax liability equal to one-half of the amount of excise tax it paid on piped natural gas during the taxable year.

Accelerate Payment of Excise Tax on Conveyances (Section 14)

The State levies an excise tax on each deed, instrument, or writing by which any interest in real property is conveyed to another person. The amount of the tax is $1.00 on each $500 of the consideration or value of the interest or property conveyed. The tax must be paid to the county register of deeds before an instrument may be recorded. One-half of this amount is retained by the county and credited to the county's general fund. The remainder is remitted to the State quarterly. Of the amount remitted to the State, 75% is credited to the Parks and Recreation Trust Fund and 25% is credited to the Natural Heritage Trust Fund.

Section 14 of the act requires that the portion of the tax revenue due to the State must be remitted monthly, as opposed to quarterly. This section becomes effective July 1, 2003, and applies to amounts collected on or after that date. No fiscal estimate is possible.

Prison Property Tax Exemption (Section 15)

Section 15 exempts a correctional facility that is located on State land, but constructed pursuant to a contract with the State, from local property taxes. This includes construction in progress and any leasehold interest in the land owned by the State upon which the correctional facility is located.

S.L. 2001-84, effective May 17, 2001, authorized the Department of Administration and Department of Correction to award a contract for the construction of up to three new close custody prisons. Governmental Operations recommended two prisons but did not designate sites. This recommendation was accepted by the Council of State. S.L. 2001-424 (SB 1005) and S.L. 2001-322 (SB 34) authorized construction of three prisons after acceptance by the Council of State.

The vendor will finance the prison construction. S.L. 2001-84 then authorizes the State to set up a Special Non-Profit Corporation to issue certificates of participation to purchase the prisons upon completion and then lease the prisons to the State. The Department of Correction (DOC) will operate the prisons. The Request for Proposal issued by DOC indicated that the State would be responsible for the property tax, rather than the vendor. Section 3 of S.L. 2001-84 exempts the State from paying property tax during the period the State is leasing the prisons from the Special Non-Profit Corporation. The Department of Correction indicates that construction began in November 2001 for two prisons and will begin on the third prison in winter, 2002. Completion dates for all three prisons are expected to be in fiscal year 2003-04. The sites for the three prisons are Alexander, Scotland and Anson Counties.

Section 15 became effective for taxable years beginning on or after July 1, 2001.

The State will save the following tax payments:

FY 2001-02	$ 700,000
FY 2002-03	$1,680,000
FY 2003-04	$ 980,000

Simplify Taxes on Telecommunications

Session Law #	*Bill #*	*Sponsor*
S.L. 2001-430, as amended by S.L. 2001-424 and S.L. 2001-487	**HB 571**	**Representative Allen**

AN ACT TO SIMPLIFY THE COLLECTION OF TELECOMMUNICATIONS TAXES.

OVERVIEW: This act, as amended, simplifies the collection of telecommunications taxes, by (1) combining multiple tax rates into one uniform rate equal to 6%[45], (2) broadening the tax base by eliminating exemptions for interstate calls and telephone membership corporations, (3) taxing prepaid phone cards at the point of sale instead of at the point of use, (4) adjusting the tax on the gross receipts from pay phones, (5) setting a call center tax cap of $50,000 a year, and (6) replacing the 3.09% franchise tax distribution to municipalities with a distribution of 18.26% of the new revenue total (less the previous freeze amount).

FISCAL IMPACT: The overall fiscal impact of the act is as follows:

($millions)

	FY 2001-02	***FY 2002-03***	***FY 2003-04***	***FY 2004-05***	***FY 2005-06***
New Rate (6.0%) & Interstate	34.4	87.9	87.9	87.9	87.9
Coin Telephones	0.4	1.6	1.6	1.6	1.6
Prepaid Phone Cards	* See Assumptions and Methodology *				
Call Centers	* See Assumptions and Methodology *				
TOTAL	34.8	89.5	89.5	89.5	89.5

EFFECTIVE DATE: The act became effective January 1, 2002, and applies to taxable services reflected on bills dated on or after January 1, 2002.

BACKGROUND: Until this act, the General Assembly had not revised the tax structure for telecommunications since 1987. Since that time, changes in the telecommunications industry had occurred that were not contemplated by the 1987 tax law changes.

[45] This act originally set the uniform rate at 4.5%. Section 34.25(a) of SL 2001-424 changed the uniform rate to 6%.

Under former law, two taxes applied to telecommunications services. The applicability of the tax varied depending upon the identity of the provider and the type of service. One of these taxes was a gross receipts franchise tax equal to 3.22% of the gross receipts derived by the provider for the provision of local telecommunications services. The second tax was a sales tax. The rate of sales tax varied: it was 3% for local telecommunications and 6.5% for intrastate long-distance calls (toll telecommunications services or private telecommunications services that both originated from and terminated in the State). By definition, the taxes did not apply to interstate long-distance calls. Telephone membership corporations had been exempt from the sales tax on telecommunications for many years and coin-operated pay telephone calls, where the call is paid for by a coin, were exempted from the sales tax in 1998.

Under the prior law distribution of part of the tax revenue to cities, a city would receive 3.09% of the gross receipts franchise tax that was collected from sales of local telecommunications service within the city, subject to a freeze deduction and a hold-harmless provision. Cities did not receive a percentage of the sales tax revenues. This distribution had become increasingly complicated to administer. The advent of cellular phones had made the task of deciding whether a call is attributable to a particular city very difficult.

During the 1990s, prepaid calling cards had become increasing popular and easy to use. They could be purchased at retail stores and other places. However, they were not taxable as tangible personal property under the State and local sales tax like most items sold in the stores where the cards were most often purchased. Because the card represented a telecommunications service, the gross receipts franchise tax and the telecommunications sales tax were imposed on the "air time" and the tax rate differed depending on the type of call. To correctly levy the tax, telephone companies had to track the minutes used by the cardholder and the type of call placed by the cardholder.

ANALYSIS: This act addresses some of the difficulties in the existing tax structure:

- It taxes prepaid telephone calling arrangements as personal property at the point of sale.
- It applies one tax at one rate to telecommunications services.
- It taxes all telecommunications services equally by eliminating exemptions for, interstate telecommunications service, coin telephone calls, and telephone membership corporations.
- It establishes a sourcing rule for mobile telecommunications.
- It preserves the revenue stream to cities while simplifying the distribution formula.

Sections 1 and 6 of the act add definitions for use in taxing telecommunications. The definition for "prepaid telephone calling arrangement" is consistent with the definition used in other states. Many of the definitions are similar to the ones previously used in G.S. 105-120. The act defines some new terms: "service address", and "mobile telecommunications service". Those definitions are consistent with the definitions in the federal Mobile Telecommunications Act and in the draft legislation being developed by a working group established by the National Conference of State Legislatures.

Section 2 repeals the definition of "utility" from the sales tax statutes because it is no longer needed. With the separate taxation of telecommunications and piped natural gas, the only industry remaining in the definition of "utility" is electricity. The act rewrites the sales tax statutes pertaining to electricity so that the term is not needed. (Sections 3, 7, and 8)

Section 4 originally set a uniform tax rate of 4.5% for all telecommunications services, except prepaid telephone calling arrangements. The 4.5% rate was chosen as a revenue neutral rate for the General Fund. Section 34.25(a) of SL 2001-424 changed the uniform rate to 6%.

Section 5 taxes prepaid telephone-calling arrangements as personal property at the point of sale and identifies the point of sale. Consequently, it sets the tax rate for prepaid telephone calling arrangements at the general State rate of 4% (after the 2001 half-cent expires in 2003) plus the applicable local rates, which are expected to be 3% in Mecklenburg County and 2 ½% in all other counties beginning in 2003.

Section 6 is the heart of the act. It sets forth the taxation of telecommunications:

- It adopts a sourcing rule for mobile telecommunications service that is substantially the same as the sourcing rule in the federal Mobile Telecommunications Act. Mobile telecommunications service is provided in this State if the customer's service address is in this State. A service address for mobile telecommunications service may be determined by the provider based upon the customer's telephone number, the mailing address to which the bills are sent, or a street address provided by the customer.

- It addresses the taxation of telecommunications service that is bundled with a service that is not taxable. In those cases, a proportion of the gross receipts from the total charges is taxable based on the unbundled price of each service or based on an allocation of revenue to each service.

- It taxes all telecommunications service, including interstate telecommunications service and service provided through a telephone membership corporation. When the General Assembly last changed the telecommunications tax laws in 1987, it was unclear whether states could constitutionally tax interstate telecommunications. However, in 1989, the U.S. Supreme Court removed this uncertainty in Goldberg v. Sweet, 488 U.S. 252, 109 S.Ct. 582, when it held that states can tax interstate telecommunications.

- It replaces the 3.22% franchise tax on local telecommunications and the 3% and 6.5% sales tax on local telecommunications with a uniform gross receipts sales tax on telecommunications.

- It eliminates the tax exemption for telecommunications service provided by means of public coin-operated pay telephones and paid for by coin. (See Section 4) It excludes from tax the receipts of a pay telephone provider from the sale of pay telephone service because the provider pays the sales tax on its purchase of those services.

- It taxes interstate private lines as follows:
    - 100% of the charge imposed at each channel termination point in this State.
    - 100% of the charge imposed for the total channel mileage between each channel termination point in this State.
    - 50% of the charge imposed for the total channel mileage between the first channel termination point in this State and the nearest channel termination point outside this State.

- It caps the tax on call centers at $50,000 a year. The cap applies to a person who purchases interstate telecommunications service that originates outside the State and terminates in this State and who has a direct pay permit issued by the Secretary of Revenue. A direct pay permit authorizes the holder to purchase telecommunications

service without paying tax to the seller and authorizes the seller to not collect any tax on a sale to a permit holder. The permit holder pays the tax directly to the Department. (Section 9)

Section 10 establishes a new distribution formula that replaces the 3.09% distribution to cities from the telephone gross receipts franchise tax with a distribution from the sales tax on telecommunications service established under this act. The new distribution formula eliminates the need for telephone companies to separately track and report local versus other calling services and the need to determine where wireless falls in the local/nonlocal mix of calls.

Under the new distribution formula, each quarter the Secretary of Revenue must first deduct from the net amount of the tax to be distributed to the cities the amount of $2,620,948. This is the amount by which the distribution to the cities of the gross receipts franchise tax on telephone companies was required to be reduced in fiscal year 1995-96. After the required deduction, the Secretary must distribute the remaining net tax proceeds to the cities. Cities incorporated before January 1, 2001, will receive a proportionate share based on the amounts they received from the gross receipts franchise tax on telephone companies. Cities incorporated on or after January 1, 2001, and cities served by telephone membership corporations will receive a per capita share.[46]

Section 11 makes a conforming change to the local franchise tax distribution formula by eliminating references to the gross receipts franchise tax on telephone companies and by clarifying that the freeze deduction applies only to the receipts attributable to electric power companies and natural gas companies.

Section 12 repeals the 3.22% gross receipts franchise tax on telephone companies. The tax is repealed because it is merged into the uniform tax on telecommunications services established in this act.

Sections 13 and 14 conform the local sales tax statutes by adding prepaid telephone calling arrangements to the local sales tax base.

Section 15 requires the Department of Revenue to report to the Revenue Laws Study Committee in October 2003 and October 2007 on the amounts collected under this act and on the distributions made to cities. The Department, in consultation with the League of Municipalities, may recommend changes to the distribution formula.

Sections 16 and 17 preserve the prohibition on county and city taxes on telecommunications services that is now contained in G.S. 105-120(d).

Section 18, as amended[47], requires the Utilities Commission to reduce the rates set for telecommunications services to reflect the repeal of G.S. 105-120 and the resulting liability of local telecommunications companies for the new uniform sales tax. The North Carolina Supreme Court upheld the Utilities Commission's authority to reduce rates under its rulemaking procedure to reflect a tax reduction that affects an industry uniformly in State ExRel. Utility Commission v. Nantahala Power & Light Company, 236 N.C. 190 (1990).

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[46] The provision for cities served by telephone membership corporations was added by section 67 of S.L. 2001-487.

[47] Section 119 of S.L. 2001-487 amended Section 18 of this act to clarify that the Utilities Commission has some flexibility in lowering rates, rather than being limited to lowering only basic local line rates by the exact amount of the reduced tax burden.

Section 19 directs the Revenue Laws Study Committee to recommend to the 2002 Session of the General Assembly any changes necessary to conform North Carolina's tax laws with the federal Mobile Telecommunications Sourcing Act.

Pass-Through Entity/Housing Tax Credit

Session Law #	*Bill #*	*Sponsor*
S.L. 2001-431	**SB 181**	**Senator Harris**

AN ACT TO ALLOW A PASS-THROUGH ENTITY TO ALLOCATE A HOUSING TAX CREDIT TO ANY OF ITS OWNERS AT THE DISCRETION OF THE PASS-THROUGH ENTITY.

OVERVIEW: This act amends the low-income housing tax credit in two ways:

- It allows a pass-through entity to allocate the low-income housing credit to any of its owners at its discretion. In effect, it allows developers of low-income housing to sell federal and State low-income housing tax credits to separate investors. The credit amount may not exceed the owner's adjusted basis in the pass-through entity. If the credit is ever forfeited, the forfeiture applies to the owners in the same proportion as the credit was allocated.
- It expands the credit by allowing it to be taken against the gross premiums tax on insurance companies.

FISCAL IMPACT: The fiscal impact of this act is not known because it is not known whether the changes to the credit allowed under this act will increase the use of the State tax credit. In calendar year 2000, only 70% of the low-income housing projects receiving the federal tax credit also requested the State tax credit. Under federal law, each state receives a tax credit of a specified per capita amount.[48] The State's tax credit is a percentage of the federal tax credit. Therefore, there is a ceiling on the total amount of State tax credit that can be claimed.

EFFECTIVE DATE: Effective for taxable years beginning on or after January 1, 2001, and applies to buildings that are placed in service on or after January 1, 2001.

ANALYSIS: In the Tax Reform Act of 1986, Congress created the Low Income Housing Tax Credit program to fund housing for low- and moderate-income households. Each state receives a limited amount of credit each year. The IRS allocates the per capita low-income housing tax credits to state housing agencies such as the North Carolina Housing Finance Agency (NCHFA). The NCHFA reviews housing project proposals and awards the tax credits to project developers based on selection criteria designed to reward projects that will serve the lowest income tenants for the longest periods. The federal credit requires that the low-income housing be used for that purpose for at least 30 years. If that requirement is not met, all or part of the taxpayer's credit is recaptured.

In S.L. 1999-360, North Carolina authorized a State income tax credit equal to a percentage of a taxpayer's federal tax credit for low income housing constructed in North Carolina.[49] The credit is equal to 75% of the federal credit for low-income housing located in Tier one or Tier

[48] In 2000, Congress increased the per capita credit to $1.50 in 2001 and $1.75 in 2002, and then indexed the credit to the CPI beginning in 2003.

[49] The credit expires for buildings allocated federal credits on or after January 1, 2006.

two counties and for housing located in a county affected by a hurricane in 1999.[50] The credit is equal to 25% of the federal credit for low-income housing located in other counties. In addition to the federal requirements, low-income housing located in a Tier three, four, or five county must meet the following State eligibility requirements:

- Housing located in a Tier three or Tier four county must have at least 40% of its residential units rent restricted and occupied by individuals whose income is 50% or less of median gross income.
- Housing located in a Tier five county must have at least 40% of its residential units rent restricted and occupied by individuals whose income is 35% or less of median gross income.

The State tax credit must be taken over a five-year period, beginning when the federal credit is first claimed for the building.[51] The federal credit is taken over an eleven-year period. If any part of the federal credit is recaptured, the taxpayer forfeits the North Carolina credit to the same extent. In addition, if the taxpayer no longer qualifies for the federal credit during one of the five years a State installment could otherwise be claimed, the taxpayer is no longer eligible for the State credit.[52]

A project developer awarded the low-income housing tax credits sells the State and federal credits to an investment group to acquire financing for a project. The investment group financing the projects may consist of pass-through entities.[53] Under federal law, tax credits are allocated among S corporation shareholders in accordance with their pro rata share of the corporation, which is determined on the basis of stock ownership, and tax credits are allocated among partners in a partnership in accordance with the partnership agreement. The allocation made by the partnership agreement must have a substantial economic effect, which means that the allocation agreement must reflect the economic interest of the partners in the partnership and cannot be based solely on tax consequences. Therefore, the allocation agreement of partners cannot give one partner a disproportionate share of the income, loss, or credits of the partnership. Generally, under North Carolina law, the pass-through entity is required to allocate a tax credit among its owners in the same proportion that other items, such as the low-income housing credit, are allocated under the Internal Revenue Code.

Prior to this act, an investment group had to purchase both the State and federal credits. This restriction limited the number of investors able to use the State tax credit primarily to in-state groups. This act allows the State credits to be allocated in a different manner than the federal credits. It allows a pass-through entity to allocate the credit among any of the entity's owners, in the entity's discretion, as long as the amount of credit allocated does not exceed the owner's adjusted basis in the pass-through entity. In effect, this act allows developers of low-income housing to sell federal and State low-income housing tax credits to separate investors. It is similar to the bifurcation or separate sale of federal and State historic tax credits approved in

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[50] The General Assembly modified the credit in S.L. 2000-56 to make housing in a county affected by a hurricane in 1999 eligible for the 75% State tax credit. This modification of the credit expires July 1, 2005.

[51] The federal credit is first claimed either when the building is placed in service, or the next year, at the taxpayer's election.

[52] This situation could occur if the taxpayer sold its interest in the low-income housing.

[53] A pass-through entity is an entity that is treated as owned by individuals or other entities under federal tax law and whose income, losses, and credits are reported by the owners on their State income tax returns. Examples of pass-through entities include partnerships, LLCs, and Subchapter S corporations.

the 1999 Session of the General Assembly in S.L. 1999-389.[54] Most housing finance experts agree that this act will increase the competition for State tax credits and that this competition will affect the price paid for a credit put up for bid. However, it is unknown whether these changes will increase the participation of developers in the State credit program. The statutory mandates on the number of rent controlled units in a project appear to prevent the 100% utilization of the State tax credit and this act does not change those restrictions.[55]

Under this act, when an allocation is claimed by a pass-through entity, the pass-through entity and its owners must include a statement with their tax return that shows both the allocations made and the allocation that would otherwise have been required.[56] If an owner of a pass-through entity that qualified for the credit disposes of all or a portion of the owner's interest in the pass-through entity within five years from the date the federal credit is first claimed so that the owner's interest is reduced to less than 2/3 of its interest at the time the federal credit is first claimed, the owner must forfeit a portion of the credit. This recapture does not apply if the change in ownership is due to the death of the owner or to a merger or consolidation requiring approval of the members of the taxpayer's pass-through entity to the extent the entity does not receive cash or property. Under existing law, any forfeiture of the credit triggers the taxpayer's liability for all past taxes avoided plus interest. The past taxes and interest are due 30 days after the credit is forfeited.

Lastly, this act makes the State tax credit for low-income housing attractive to insurance companies by allowing the credit to be applied against the gross premiums tax. Prior to this act, the credit for low-income housing was allowed only against the franchise tax or the income tax. Insurance companies pay gross premiums tax in lieu of income and franchise tax.

Counties Collect Delinquent Taxes Before Record Deeds

Session Law	*Bill #*	*Sponsor*
S.L. 2001-464, as amended by S.L. 2001-513	**HB 108**	**Representative Haire**

AN ACT TO AUTHORIZE ALLEGHANY, ANSON, BEAUFORT, CABARRUS, CAMDEN, CHEROKEE, CHOWAN, CURRITUCK, FORSYTH, GRAHAM, GRANVILLE, HARNETT, HAYWOOD, JACKSON, LEE, MADISON, MONTGOMERY, PASQUOTANK, PERQUIMANS, PITT, STANLY, SWAIN, VANCE, WARREN, AND YADKIN COUNTIES TO REQUIRE THE PAYMENT OF DELINQUENT PROPERTY TAXES BEFORE RECORDING DEEDS CONVEYING PROPERTY.

OVERVIEW: This act authorizes the county commissioners in 25 different counties to require the register of deeds to refuse to register a deed unless the county tax collector has certified that no delinquent taxes are due on the property. S.L. 2001-513 gives this same authority to the county commissioners in an additional 10 counties.

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[54] See the summary for S.L. 2001-476, *Pass-Through Entity Allocation Extension*.

[55] All 7 projects in Tier one and two counties and all 6 projects in Tier three and flood relief counties utilized the 75% State tax credit. However, only 12 of the 23 projects in Tier four and five counties utilized the 25% State tax credit.

[56] See G.S. 105-131.8 and G.S. 105-269.15.

FISCAL IMPACT: The fiscal impact on local governments is unknown. The act provides counties with a potential tool to assist them with the collection of delinquent property taxes.

EFFECTIVE DATE: This act became effective November 16, 2001. S.L. 2001-513 became effective January 4, 2002.

ANALYSIS: Since 1963, the General Assembly has prohibited the register of deeds in several counties from recording deeds unless the tax collector certifies that no delinquent taxes are due: Avery County (1963); Mitchell County (1987); Ashe County (1993); the Towns of Newland, Spruce Pine, and Alleghany County (1997); the Town of Banner Elk (1998); and the Town of Bakersville (1999).

This act gives the county commissioners in 25 counties the authority to adopt a resolution requiring the county tax collector to certify that no delinquent taxes that the collector is charged to collect are due on the property before a deed transferring the property can be recorded. Those 25 counties are: Alleghany[57], Anson, Beaufort, Cabarrus, Camden, Cherokee, Chowan, Currituck, Forsyth, Graham, Granville, Harnett, Haywood, Jackson, Lee, Madison, Montgomery, Pasquotank, Perquimans, Pitt, Stanley, Swain, Vance, Warren, and Yadkin Counties. S.L. 2001-513 gives the same authority to the following 10 counties: Carteret, Cleveland, Davidson, Gaston, Iredell, Martin, Person, Rockingham, Rowan, and Washington Counties. Unlike the previous local acts, the authority given by these two acts is permissive. To use this collection tool, the board of county commissioners must adopt a resolution on the matter. The resolution may describe the form the certification must take.

GRAPE GROWERS COUNCIL FUND

AN ACT TO INCREASE THE AMOUNT OF WINE TAX PROCEEDS EARMARKED ANNUALLY FOR THE GRAPE GROWERS COUNCIL.

Session Law	*Bill #*	*Sponsor*
S.L. 2001-475	**SB 970**	**Senator Kerr**

OVERVIEW: This act expands the quarterly distribution of a portion of the excise tax on wine to the North Carolina Grape Growers Council by increasing the earmarking to 100% of the excise tax and raising the cap from $175,000 to $350,000.

FISCAL IMPACT: The act doubles the amount of tax revenue that may be distributed to the North Carolina Grape Growers Council from $175,000 to $350,000.[58] It is anticipated that the Council will receive an additional $109,382 in fiscal year 2001-02 and an additional $147,936 in fiscal year 2002-03 before reaching the $350,000 cap in fiscal year 2003-04. The additional funds that will go to the Council would, under prior law, be divided between the State's General Fund and the counties and cities in which the sale of wine is authorized.[59]

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[57] Alleghany County currently has the authority. This act includes Alleghany County because it allows the county commissioners to decide what form the certification may take, something the original authorization does not expressly address.

[58] The prior $175,000 cap did not come into play until the final quarter of the 1999-2000 fiscal year.

[59] Under G.S. 105-113.82, the Secretary of Revenue must annually distribute the net amount of excise taxes collected on fortified and unfortified wine, less the amount of net proceeds distributed to the North Carolina Grape Growers Council, to local governments. Local governments receive 62% of the net

Therefore, the gain in revenues to the Council is accompanied by a corresponding reduction in the revenues distributed to the State and the applicable counties and cities.

EFFECTIVE DATE: October 1, 2001.

ANALYSIS: Under prior law, 94% of the net proceeds of the excise tax collected on unfortified wine bottled in North Carolina during the previous quarter and 95% of the net proceeds of the excise tax collected on fortified wine bottled in North Carolina during the previous quarter were credited to the Department of Agriculture. The amount credited could not exceed $175,000 per fiscal year. The act changes the distribution amount to 100% of each tax on wine bottled in North Carolina, and raises from $175,000 to $350,000 the annual cap on the amount to be distributed.

The Department of Agriculture must continue to allocate these funds to the North Carolina Grape Growers Council to be used to promote the North Carolina grape and wine industry and to contract for research and development services to improve viticultural and enological practices in North Carolina. If any of the earmarked funds are not expended during the fiscal year, they do not revert to the General Fund but remain available to the Grape Growers Council.

Bill Lee Act Changes

Session Law	*Bill #*	*Sponsor*
S.L. 2001-476, as amended by S.L. 2001-487	**SB 748**	**Senator Hoyle**

AN ACT TO AMEND THE WILLIAM S. LEE QUALITY JOBS AND BUSINESS EXPANSION ACT; TO APPLY A GRADUATED TAX RATE TO SALES OF ELECTRICITY TO MANUFACTURERS BASED ON ANNUAL VOLUME OF ELECTRICITY USED; TO APPLY DEFINITIONS FROM THE STREAMLINED SALES TAX PROJECT TO THE SALES TAX HOLIDAY; AND TO PROVIDE A FOUR-YEAR EXTENSION ON THE EXEMPTION FROM BIDDING LAW REQUIREMENTS FOR THE PIEDMONT TRIAD INTERNATIONAL AIRPORT AUTHORITY.

OVERVIEW: This act makes numerous changes to the William S. Lee Quality Jobs and Business Expansion Act, modifies the sales tax rate that applies to electricity used by manufacturers, modifies definitions in the new sales tax holiday to conform to the streamline legislation, and extends the bidding law exemption for the Piedmont Triad Airport Authority.

EFFECTIVE DATES AND FISCAL IMPACT:

Provision	*Effective Date*	*Fiscal Impact*
Makes numerous clarifications and changes to the definitions regarding eligible businesses under the Bill Lee Act. Expands the law to allow a taxpayer to qualify for credits if:	The clarifications regarding businesses eligible for credits under the Bill Lee Act	FY 2003-04 -$ .2 million FY 2004-05 -$1.1 million FY 2005-06

amount of excise taxes collected on unfortified wine and 22% of the net taxes collected on fortified wine. The remainder is credited to the General Fund.

Provision	Effective Date	Fiscal Impact
• It has an establishment whose primary activity is in computer services. • It has an establishment whose primary activity is an electronic shopping and mail order house. • It has an establishment whose primary activity is warehousing and is located in a tier 1, 2, or 3 county, serves at least 5 counties, and is located in a separate site. • The primary business is manufacturing, warehousing or wholesale trade and the jobs, investment, or activity with respect to which a credit is claimed are used in any of those types of businesses.	became effective November 29, 2001. Those clarifications do not reflect a change in the law regarding eligible businesses. The expansion of businesses eligible for credits under the Bill Lee Act are effective for taxable years beginning on or after January 1, 2001.	-$2.5 million (maximum impact of -$4.5 million in 2006-07)
Increases the population thresholds used in determining county tier designations. Gives low population counties more favorable tier designations.	This provision became effective November 29, 2001, and applies to designations made on or after that date.	FY 2003-04 -$ .2 million FY 2004-05 -$ .4 million FY 2005-06 -$ .6 million (maximum impact of -$.9 million in 2006-07)
Extends tax credits to customer service centers and electronic mail order houses located in tier 3 areas.	Effective for taxable years beginning on or	FY 2002-03 -$ .3 million FY 2003-04

Provision	Effective Date	Fiscal Impact
	after January 1, 2001.	-$ .6 million FY 2004-05 -$ .9 million FY 2005-06 -$1.2 million (maximum impact of -$1.2 million in 2005-06)
Clarifies when credits expire under the act.	Effective November 29, 2001.	
Makes changes to the wage standard.	Effective for taxable years beginning on or after January 1, 2002.	
Amends safety and health and environmental standards.	The major change to the safety and health standards is effective for taxable years beginning on or after January 1, 2000. Conforming changes are effective for taxable years beginning on or after January 1, 2002.	
Extends the carryforward for research and development credits from 5 years to 15 years.	Effective for taxable years beginning on or after January 1, 2002.	No impact until FY 2008-09.
Shortens the period in which credits under the Lee Act may be claimed.	Effective for taxable years beginning on or after January 1, 2001.	

Provision	*Effective Date*	*Fiscal Impact*
Eliminates the Department of Commerce's role in certification of applications and changes in fees and reports.	As amended by S.L. 2001-487, effective for business activities that occur on or after January 1, 2002, and for activities occurring before that date for which no application has been filed by January 1, 2003. Special interim procedures are used for businesses activites occurring before January 1, 2002 for which an application is filed before January 1, 2003.	
Clarifies the machinery and equipment threshold.	Effective for taxable years beginning on or after January 1, 2002, and applies to machinery and equipment put in service after that date.	
Eliminates a clawback provision regarding the credit for central office and aircraft facility property.	Effective for taxable years beginning on or after January 1, 2001.	

Provision	Effective Date	Fiscal Impact
Creates a new 30% tax credit for the purchase or lease of real property. The tax credit must be taken over 7 years and has a 20-year carryforward. The taxpayer must invest at least $10 million within 3 years and create 200 jobs within 2 years.	Effective for taxable years beginning on or after January 1, 2002, and applies to property that is first used in an eligible business on or after that date.	FY 2003-04 -$ 4.7 million FY 2004-05 -$ 9.4 million FY 2005-06 -$14.3 million (maximum impact of -$18.7 million in 2006-07)
Extends the FedEx bidding law exemptions.	Effective November 29, 2001.	
Reduces the sales tax on electricity sold to manufacturers from 2.83% to the following: (As amended by S.L. 2001-487.) Over 5,000 and up to 250,000 megawatts = 2.25% beginning July 1, 2005. Over 250,000 and up to 900,000 megawatts – 2% beginning July 1, 2005 Over 900,000 megawatts - .17% beginning January 1, 2002.	As amended by S.L. 2001-489, this section becomes effective in part on January 1, 2002, and in remainder on July 1, 2005.	FY 2002-03 -$ .8 million FY 2003-04 -$ .8 million FY 2004-05 -$ .8 million FY 2005-06 -$7.0 million
Sales tax holiday amendments.	Effective January 1, 2002, and applies to sales made on	
Extension of special allocation rules for pass-through entities for the historic rehabilitation credit.	Effective November 29, 2001.	

ANALYSIS:

The William S. Lee Quality Jobs and Business Expansion Act (hereinafter Bill Lee Act) was enacted in 1996, effective beginning with the 1996 tax year with a 2002 sunset. The Act is a

package of State tax incentives and has been modified in each subsequent year. The incentives are primarily in the form of tax credits for investment in machinery and equipment and real property, for job creation, for worker training, and for research and development. Counties are divided into five economic distress tiers based on the unemployment rate, per capita income, and population growth of the county. For many of the credits, the lower the tier of a county, the more favorable the incentive. The Act requires the Department of Commerce and the Department of Revenue to report periodically on the credits allowed by the Act.

Before 1996, North Carolina had made little use of tax incentives to lure businesses to the State. Even without incentives, North Carolina was consistently one of the top states in attracting industry. The array of credits authorized by the Bill Lee Act was viewed as an experiment, to be evaluated in five years to determine whether the incentives were cost effective and actually affected behavior, or merely provided tax reductions to businesses that would have located or expanded in any case. In 1999, the General Assembly expanded existing tax incentives for businesses, added new tax incentives and tax reductions for specific businesses, and made related changes. The General Assembly also extended the 2002 sunset to 2006.

During the 2000 Session, the General Assembly further modified the Bill Lee Act and related economic development laws by enacting application fee changes, extending credit carryforwards, requiring wage standards for grants, prohibiting funding for defaulting grantees, expanding credits, amending the tier designation formula, and making technical corrections.

This act makes the following changes to the Bill Lee Act:

Eligible business rules and definitions.

Sections 1 and 6 of this act make numerous clarifications and changes to the definitions regarding eligible businesses under the Act.

Section 1(a) clarifies that a taxpayer is eligible for a credit under the Bill Lee Act only if the primary business of the taxpayer is an eligible business under the Act. There had been some confusion on the part of taxpayers as to whether a taxpayer whose primary business is not an eligible business but who nonetheless engaged in eligible business activities at a certain location was eligible for credits under the Act. This clarification is consistent with the interpretation of the Act by the Department of Revenue[60]. This is a clarifying amendment and does not change existing law. Section 1(a) became effective when it became law, November 29, 2001.

Section 1(b) amends the definitions to remove the requirements regarding primary business from the definitions. These requirements are moved to the eligible business statute, G.S. 105-129.4(a), in Section 6(a) of the act. Section 1(b) also amends the definition of "data processing" by splitting it into two definitions, "computer services" and "data processing", and restricting it so that in order for a taxpayer to be engaged in one of these activities, the services must be provided primarily to entities that are not related entities[61]. In addition, Section 1(b) provides a new definition of data processing that does not explicitly refer to the NAICS definition. Section 1(b) is effective for taxable years beginning on or after January 1, 2001.

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[60] G.S. 105-264 imposes the duty of interpreting the tax laws upon the Secretary of Revenue.

[61] Section 1(b) incorporates the definition of related entity found in G.S. 105-130.7A. G.S. 105-130.7A was enacted into law earlier this session in House Bill 1157 – Enforce Tax Compliance and Equality/No Fraud.

Section 6(a) of the act amends G.S. 105-129.4(a), effective for taxable years beginning on or after January 1, 2001, to relax the eligible business requirements as follows:

- Computer services. The law is expanded to allow a taxpayer to qualify for credits if it has an establishment whose primary activity is in computer services. Under previous law, a taxpayer was eligible for a credit for this industry only if the primary business of the taxpayer was in that industry.
- Electronic mail order house. The law is expanded to allow a taxpayer to qualify for credits if it has an establishment whose primary activity is an electronic shopping and mail order house. Under previous law, a taxpayer was eligible for a credit for an electronic mail order house only if the primary business of the taxpayer was an electronic shopping and mail order house.
- Warehousing. Under previous law, a taxpayer was engaged in warehousing only if the primary business of the taxpayer was warehousing. The law is expanded to include a taxpayer whose primary business is not an eligible business if it has an establishment whose primary activity is warehousing and it meets each of the following conditions:
    - The establishment is located in an enterprise tier one, two, or three area.
    - The establishment is at a site separate from other subdivisions of the taxpayer.
    - The establishment serves at least 25 establishments in at least five different counties in one or more states.
- Multiple businesses. The law is expanded to allow a taxpayer to claim credits under the Bill Lee Act if the primary business of the taxpayer is manufacturing, warehousing, or wholesale trade, and the jobs, investment, or activity with respect to which a credit is claimed are used in any of those types of business. Under previous law, a taxpayer could claim a credit under the Act only if the jobs, investment, or activity with respect to which a credit was claimed were used within the primary business of the taxpayer.

In each of these cases, it has been argued that a taxpayer whose primary business is in another industry might nonetheless engage in significant activities in one of these areas. Section 6(a) allows such a taxpayer to be eligible for credits under the Bill Lee Act.

Tier designation formula change

Section 3 of this act makes two changes to the tier designation formula. In general, counties are divided into five economic distress tiers based on the unemployment rate, per capita income, and population growth of the county. In 1999, the General Assembly amended the tier designation formula to give a more favorable tier designation to certain lower-population counties. Under previous law there are three exceptions for lower-population counties:

1. A county that had a population of less than 10,000 and more than 16% of its population below the federal poverty level was designated an enterprise tier one area.
2. A county that had a population of less than 50,000 and more than 18% of its population below the federal poverty level was given a tier designation one level lower than it otherwise would have received.
3. A county that had a population of less than 25,000 could not be designated higher than an enterprise tier three area.

This act increases the population thresholds that are used in 1. and 3. above from 10,000 to 12,000 and from 25,000 to 35,000, respectively. The Department of Commerce reports that the counties that are affected by the first change are Alleghany and Jones. The counties affected by the second change are Alexander, Dare, Davie, Macon, and Transylvania. This section became effective when it became law, November, 29, 2001, and applies to tier designations that are made on or after that date.

Call center

In 1999, the General Assembly amended the Bill Lee Act so that certain electronic mail order houses and certain customer service centers were eligible for credits under the Bill Lee Act. The first incentive extends all of the Bill Lee Act credits to electronic mail order houses that create at least 250 jobs and that are located in an enterprise tier one or two area. The second incentive extends all of the Bill Lee Act credits to certain customer service centers located in an enterprise tier one or two area. An eligible customer service center is a subdivision of a telecommunications or financial services company that provides support services to the company's customers by telephone to support the company's products and services. To qualify, at least 60% of the center's calls must be incoming. This requirement prevents telemarketing operations from qualifying.

This act (Section 6) expands the number of taxpayers eligible for credits under the Bill Lee Act by including customer service centers and electronic mail order houses located in enterprise tier three areas. This change is effective for taxable years beginning on or after January 1, 2001.

Clarification of expiration of credits

In 2000, the General Assembly amended the Bill Lee Act to clarify that if a taxpayer ceased to engage in an eligible business, credits under the Act would expire and the taxpayer would not be allowed to take any further installments of the credit. Expiration of a credit, however, does not prevent a taxpayer from taking any carryforwards of previous installments of the credit. In several instances, an eligible business is defined not only by industry type, but also by the number of jobs created or the enterprise tier designation of the location. It was not entirely clear what the effect would be on a taxpayer's credits if the taxpayer was still involved in an eligible industry, but the number of employees dropped below the applicable threshold or the enterprise tier designation of the location rose above the applicable threshold.

Section 6 of this act clarifies that credits under the Bill Lee Act expire if the number of jobs at a central administrative office drops below 40 or if the number of jobs at an electronic mail order house drops below 250. Section 6 further clarifies that a change in the tier designation of the location of a customer service center or an electronic mail order house does not result in expiration of the credits. These changes became effective when the act became law, November 29, 2001.

Section 6 also clarifies the period of time during which a central administrative office may meet the requirement that it create at least 40 jobs.

Wage standard

To be eligible for the credits under the Bill Lee Act, jobs must meet the applicable wage standard. Under previous law, for the credit for worker training or the credit for creating new jobs, the jobs for which a credit was claimed were required to meet the applicable wage standard. For the credit for investing in machinery and equipment, the credit for research and development, and the credit for investing in central office and aircraft facility property, the jobs at the location with respect to which a credit was claimed were required to meet the

applicable wage standard. For a tier one county, the jobs were required to pay an average weekly wage that was equal to the applicable average weekly wage for that county. For other tier counties, the average weekly wage of the jobs had to equal 110% of the applicable average weekly wage for that county.

Section 6 of this act makes several changes to the wage standard test. First, this act clarifies that the average wage of all jobs at the facility must exceed the applicable average weekly wage for the credit for investing in machinery and equipment, the credit for research and development, the credit for investing in central office and aircraft facility property, and the credit for substantial investment in other real property[62]. Second, this act changes the wage standard test for the credit for worker training and the credit for creating new jobs. For those two credits, the average wage of the jobs for which the credit is claimed <u>and</u> the average wage of all jobs at the facility must exceed the applicable average weekly wage.

Safety and health and environmental eligibility amendments

Section 5 of this act makes changes to the safety and health program eligibility requirement under the Bill Lee Act. Previously, a taxpayer was ineligible for a credit under the Bill Lee Act if the taxpayer had any outstanding violations under the Occupational Safety and Health Act or had had any serious violations of that Act in the past three years. Section 5 of the act changes this standard in two ways. First, the new standard focuses only on citations that have become a final order. Second, instead of looking for "serious" violations the new standard looks for "willful serious" or "failure to abate serious" violations. The new standard would make more taxpayers eligible for credits under the Bill Lee Act. Section 5 is retroactive to taxable years beginning on or after January 1, 2000.

Section 6 of this act also changes the reporting procedures for the safety and health eligibility requirement and for the environmental impact requirements. Under previous law, Commerce had to report to the Department of Labor those taxpayers who claimed to meet the safety and health eligibility requirement and Labor could audit them randomly. Section 6 of the act provides that instead Labor will report to the Department of Revenue those employers who have final orders that would make them ineligible for credits. Similarly, under previous law, Commerce had to report to the Department of Environment and Natural Resources those taxpayers who claimed to meet the environmental impact eligibility requirements and DENR could perform random audits. Section 6 of the act provides that instead DENR will report to Revenue those persons who have pending or final determinations that would disqualify them from claiming credits.

Extended carryforward periods

The Bill Lee Act credits may not exceed 50% of the tax against which they are claimed. The limitation applies to the cumulative amount of credit claimed by the taxpayer, including carryforwards. As a general rule, any unused portion of a credit may be carried forward five years. Previously, the Bill Lee Act provided three exceptions that allowed longer carryforwards. Those three exceptions are:

1. Any unused portion of a credit with respect to a large investment may be carried forward for 20 years. A large investment is one where an eligible business purchases or leases, and places in service within a two-year period, $150 million worth of one or

[62] This is a new credit created by this act and is discussed further below.

more of the following: real property, machinery and equipment, or central office or aircraft facility property.

2. Any unused portion of a credit with respect to the technology commercialization credit may be carried forward for 20 years. The General Assembly created the technology investment credit in 1999 as an alternative to the 7% credit for investing in machinery and equipment. The credit applies only to investments in machinery and equipment used in production based on technology licensed from a research university. The investments must be located in a tier one, two, or three county and must equal at least $10 million during the taxable year and must total at least $100 million over a five-year period.
3. Any unused portion of a credit may be carried forward for 10 years if the Secretary of Commerce certifies that the taxpayer will purchase or lease, and place in service in connection with an eligible business within a two-year period, at least $50 million worth of one or more of the following: real property, machinery and equipment, or central office or aircraft facility property. If the taxpayer fails to make the level of investment certified within the two-year period, the taxpayer forfeits the enhanced carryforward period.

This act (Section 7) creates two additional exceptions that allow longer carryforwards. Under this act, any unused portion of a credit with respect to research and development under G.S. 105-129.10 may be carried forward for 15 years. Additionally, any unused portion of a credit for substantial investment in other property[63] under G.S. 105-129.12A may be carried forward for 20 years. These changes are effective for taxable years beginning on or after January 1, 2002, and apply to credits that are first claimed on or after that date.

Statute of Limitations

Section 7 of the act establishes a statute of limitations so that Bill Lee Act credits cannot be taken more than six months after the deadline for filing the tax return (including extensions) on which they are claimed. This change is effective beginning with the 2001 tax year. In general, an overpayment may be refunded only if the discovery is made or the written request for a refund made within 3 years of the date set by statutes for filing the return or within 6 months of the date of the overpayment, whichever is later.

Bill Lee credits applications, fees, and reports

Under previous law, to claim a credit under the Bill Lee Act a taxpayer had to provide with the tax return the certification of the Secretary of Commerce that the taxpayer met all of the eligibility requirements with respect to each credit that the taxpayer claimed. This act (Sections 8 and others) eliminates the requirement that a taxpayer must get the certification of the Secretary of Commerce in order to claim a Bill Lee Act credit. Commerce will continue to establish enterprise tier and development zone designations and will make written determinations regarding the requirements for development zone projects, large investments, the investment amount for enhanced carryforwards, and the investment amount for the new credit for substantial investment in other property.

As amended by S.L. 2001-487, this change is effective for business activities occurring on or after January 1, 2002, and for business activities occurring before January 1, 2002, for which no application has been filed with the Department of Commerce by January 1, 2003. For business activities occurring before January 1, 2002, for which an application is filed with the

[63] This is a new credit created by this bill and is discussed further below.

Department of Commerce before January 1, 2003, special interim procedures are used. The taxpayer must file an application, along with any applicable fees, with the Department of Commerce. The Department of Commerce shall not make any determination regarding eligibility for the credits and shall not issue a certification, but shall instead mark the application as paid and return it to the taxpayer. The taxpayer must then submit the marked application to the Department of Revenue with the relevant tax return. The fees shall be divided between the two departments as under previous law. These interim procedures were put into place as the result of a compromise between the Department of Commerce and the Department of Revenue. Since the Department of Commerce's role in certification was being eliminated, that department wanted to end all association with certification as soon as possible. The Department of Revenue needed the interim period because that department had no feasible way to collect the fee during 2002.

Taxpayers will still pay the fee that is currently paid with the application, but under this act it must be paid to the Department of Revenue with the tax return filed for the year in which the eligible activity was engaged. The fee may be paid late, however, as long as it is paid before the credit is claimed.

Under Section 6 of this act, a taxpayer may seek an advisory ruling from the Secretary of Revenue regarding the taxpayer's eligibility for a credit. Such a ruling will help taxpayers determine in advance whether planned activity will qualify for a credit. This change became effective beginning with the 2002 taxable year.

Section 9 of this act changes the requirement that taxpayers report the number of development jobs that are filled by residents of development zones. This requirement now applies only to jobs located in development zones. This change became effective beginning with the 2002 taxable year.

Section 2 of the act provides that the Department of Commerce's equity and impact studies ("Luger Report") will be updated every two years. This change became effective November 29, 2001. Previously, the Department of Commerce was required to perform these studies only once and to report on them by April 1, 2001.

Section 8 of the act requires that more detailed information be published annually by the Department of Revenue, including an itemization of Bill Lee Act credits by individual taxpayer. Section 8 became effective beginning with the 2002 tax year.

Machinery and equipment credit changes

Section 10 clarifies how the threshold applies to taxpayers who invest in more than one tier. The threshold varies depending on the enterprise tier where the machinery and equipment are placed in service. Previous law stated that if machinery and equipment were placed in service in more than one area, the threshold applied separately to each area. The Department of Revenue had interpreted "area" to mean "enterprise tier area". Section 10 of this act clarifies that the threshold applies separately to each establishment of the taxpayer rather than to each enterprise tier area. An establishment is generally a site or location. Section 10 became effective for machinery and equipment placed in service on or after January 1, 2002.

Central office or aircraft facility property credit

Section 12 of this act removes a provision regarding the expiration of the credit for investing in central office or aircraft facility property. Under previous law, the credit for investing in central office or aircraft facility property expired if the total number of people employed at the taxpayer's central office or aircraft facilities Statewide fell by 40 or more. This provision

applied only to the credit for investing in central office or aircraft facility real property – the other credits under the Act were not affected by a drop of 40 or more employees. Section 12 removes this provision. However, as is clarified in Section 6 of the act, the credit for investing in central office or aircraft facility property expires if the number of employees at the office or facility falls to below 40. Section 12 is effective for taxable years beginning on or after January 1, 2001.

New credit for substantial investment in other property

Section 13 creates a new credit under the Bill Lee Act for substantial investment in other real property. This credit is modeled upon the existing credit for investment in central office or aircraft facility property. There are, however, some notable differences between the two credits. In order for the taxpayer to claim the credit for substantial investment in other property, the Secretary of Commerce must make a written determination that the taxpayer is expected to invest at least $10 million in real property at a location within a three-year period and that the location will create at least 200 new jobs within two years of the time that the property is first used in an eligible business. In contrast, there is no minimum investment amount for the credit for investing in central office or aircraft facility property. For both credits, the taxpayer may begin to claim the credit once the property is first used in an eligible business. The amount of the credit for substantial investment in other property is equal to 30 percent of the eligible investment amount and must be taken in installments over a seven-year period. There is no ceiling on the amount of the credit. In contrast, the credit for investing in central office or aircraft facility property is equal to seven percent of the eligible investment amount and has a ceiling of $500,000. The credit for substantial investment in other property expires if the number of people employed at the location falls below 200. As mentioned earlier, the carryforward period for the credit for substantial investment in other property is 20 years, whereas the carryforward period for the credit for investment in central administrative office or aircraft facility property is the standard five years. A taxpayer may not claim both the credit for substantial investment in other property and the credit for investing in central office or aircraft facility property with respect to the same property.

In several other sections of the act, conforming changes related to this new credit were made. This credit became effective for taxable years beginning on or after January 1, 2002, and applies to property first used in an eligible business on or after that date.

FedEx extension

In 1998, the General Assembly amended the Bill Lee Act and other tax laws to provide an incentive for the development of interstate air courier hubs. An air courier is an air carrier that delivers individually addressed letters, parcels, and packages. Examples of air couriers include UPS and Federal Express. One provision of that act granted a bidding law exemption for the Piedmont Triad Airport Authority. The exemption is effective for a five-year period beginning January 1, 1999, and applies to design and construction of an air freight distribution facility on airport property, and related supplies, equipment, and services. Section 16 of this act extends the period of that exemption for an additional four years, until January 1, 2008. This extension would benefit the Federal Express project in Greensboro. This change became effective November 29, 2001.

Sales tax on certain electricity

Section 17 of the act, as amended by S.L. 2001-487, reduces the sales tax on electricity sold to manufacturers. Currently, electricity that is sold to a manufacturer for use at a manufacturing facility and that is separately metered or measured is subject to the sales and use tax at a rate

of 2.83% – most other sales of electricity are taxed at the rate of 3%. Section 17 enacts a new tax rate schedule that will apply to all manufacturers, based on volume of electricity used annually. Beginning January 1, 2002, each taxpayer will pay one rate on electricity throughout the year. The rate will be based initially on actual usage the previous year or, in the case of a new manufacturer, estimated usage for the current year. At the end of the year, if the taxpayer has used a volume of electricity that would qualify the taxpayer for a different rate, the taxpayer would be eligible for a refund of excess taxes paid or liable for a deficiency. Beginning on January 1, 2002, manufacturers who use more than 900,000 megawatt-hours of electricity annually will pay a rate of 0.17% while all other manufacturers will continue to pay a rate of 2.83%. Beginning, July 1, 2005, the following rate schedule goes into effect[64]:

Megawatt-hours used annually	Rate
5,000 or less	2.83%
Over 5,000 and up to 250,000	2.25%
Over 250,000 and up to 900,000	2.00%
Over 900,000	.17%

This section also clarifies that electricity does not "enter into" or become a component part of tangible personal property that is manufactured and is not an accessory to equipment.

Section 15 of the act requires the Revenue Laws Study Committee to review the taxation of electricity and piped natural gas used by manufacturers.

Sales tax holiday amendments

Section 18 of the act incorporates certain definitions from the Streamlined Sales Tax Project into the sales tax holiday provision. The definitions of "clothing", "clothing accessories or equipment", "protective equipment", and "sport or recreational equipment" were not included in S.L. 2001-347, Senate Bill 144, because at the time that act became law there was no special treatment of these items for sales tax purposes. The enactment of the sales tax holiday in S.L. 2001-424, Senate Bill 1005, created an instance of differential treatment of these items. Handbags appear to be the only item negatively affected by this change – with this amendment they would no longer be exempt from sales tax during the sales tax holiday. Sport and recreational equipment would be included in the sales tax holiday; it is unclear if these items would be included under the sales tax holiday as enacted by S.L. 2001-424.

Pass-through entity allocation extension

Taxpayers are allowed an income tax credit of 20% of the expenses of rehabilitating an income-producing historic structure if the taxpayer qualifies for the federal credit. A pass-through entity may qualify for the rehabilitation credit and pass the credit on to its owners. A pass-through entity is an entity, such as a partnership, a limited liability company, or a Subchapter S corporation, that is treated as owned by individuals or other entities under federal tax law and whose income, losses, and credits are reported by the owners on their State income tax returns. Under the Code, tax credits are allocated among S corporation shareholders in accordance with their pro rata share of the corporation, which is determined on the basis of

[64] Under S.L. 2001-476, the number of megawatt-hours used to receive the lower rate was 1,200,000 and the effective date for the lower rate was July 1, 2002. S.L. 2001-487 reduced the number of megawatt-hours used to 900,000 and changed the effective date to January 1, 2002.

stock ownership, and tax credits are allocated among partners in a partnership in accordance with the partnership agreement. The allocation made by the partnership agreement must have a substantial economic effect, which means that the allocation agreement must reflect the economic interest of the partners in the partnership and cannot be based solely on tax consequences. Therefore, the allocation agreement of partners cannot give one partner 100% of the income, loss, or credits of the partnership. Generally, under North Carolina law, the pass-through entity is required to allocate a tax credit among its owners in the same proportion that other items, such as the federal rehabilitation credit, are allocated under the Code. In 1999, the General Assembly amended G.S. 105-129.35 to allow a pass-through entity to allocate this particular credit among its owners at its discretion. That change would have expired for taxable years beginning on or after January 1, 2002. This section extends that provision for an additional two years.

Technical, conforming, and clarifying changes

Section 6 of the act clarifies the forfeiture language of G.S. 105-129.4, as requested by the Department of Commerce. Section 6 and other sections remove references to Commerce "certifying" that taxpayers "will" make certain investments, and provides instead that Commerce will "determine in writing" that the taxpayer "is expected to" make the investment. In addition there are numerous other technical and conforming changes throughout the act related to the new credit for substantial investment in other property and to the elimination of the certification process.

Technical Correction Act

Session Law #	*Bill #*	*Sponsor*
S.L. 2001-487	**HB 338**	**Representative Culpepper**

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.

OVERVIEW: This act makes technical corrections, conforming and other changes to various statutes and session laws. This summary covers those sections of the act that contain changes related to finance matters.

FISCAL IMPACT: The part of the act that reduces the megawatt-hour volume threshold for determining tax rates for electricity used by manufacturers and amends the effective date for this rate change reduces General Fund revenues for fiscal year 2001-02 by $322,000.

EFFECTIVE DATE: See the analysis.

ANALYSIS: Section 67 makes technical changes to S.L. 2001-430, Simplify Taxes on Telecommunications. It corrects statutory references and terminology and it amends G.S. 105-164.44F to provide for a tax distribution to cities served by a telephone membership corporation.[65] This section became effective January 1, 2002.

[65] See the summary for S.L. 2001-430 for a more complete explanation of this tax law change.

Section 68 provides that no highway use tax applies when a motor vehicle title is reissued to remove one or more co-owner's names as long as there is no consideration for the transfer. This change became effective December 16, 2001.

Section 69 deletes redundant language since the applicable oath requirement for tax returns is already contained in G.S. 105-252. It also exempts from sales tax telecommunications charges that would otherwise be inadvertently subjected to tax under S.L. 2001-430, Simplify Taxes on Telecommunications, due to a change in definitions. These charges are paid by State agencies and local governments and are not taxed. This section became effective January 1, 2002.

Section 70 deletes a redundant word that was left in the statute due to a redlining error. This section became effective December16, 2001.

Section 118 repeals a section of S.L. 2001-427 that no longer has an effect since it amends a statute that has been subsequently repealed. It also corrects the introductory language of another section of the same session law to correctly reflect what is being set out for redlining. This section became effective December 16, 2001.

Section 119 amends a provision passed in the Current Operations and Appropriations Act of 2001 in order to clarify that the Utilities Commission has some flexibility in lowering rates, rather than being limited to lowering only basic local line rates by the exact amount of the reduced tax burden. This change related to the telecommunications changes enacted in S.L. 2001-430. This section became effective December 16, 2001.

Section 122 reduces the megawatt-hour volume threshold for determining tax rates for electricity received by industries or plants. It also amends the effective date for the electricity provisions of S.L. 2001-476, Bill Lee Act Changes.[66] This section becomes effective December 16, 2001, and applies to sales made on or after January 1, 2002.

Section 123 amends S.L. 2001-476 to eliminate the Department of Commerce's role in certifying applications for credits as soon as possible, but to still maintain a mechanism for the collection of fees paid in connection with the credits until the Department of Revenue can take over. This section became effective December 16, 2001.

Vehicle Transition/HMOs/Prepared Food

Session Law #	*Bill #*	*Sponsor*
S.L. 2001-489	**HB 748**	**Representative Nesbitt**

AN ACT TO PROVIDE TRANSITIONAL PROVISIONS FOR THE REPEAL OF THE HIGHWAY USE TAX CAP ON NONCOMMERCIAL MOTOR VEHICLES, TO TEMPORARILY MODIFY THE TAXATION OF HMOS AND MEDICAL SERVICE CORPORATIONS, AND TO CLARIFY THE SALES TAX EXEMPTION FOR PREPARED FOOD.

OVERVIEW: This act contains the three provisions listed below:

- Section 1 provides that the repeal of the $1,500 highway use tax cap effective October 1, 2001, does not apply to vehicle titles issued pursuant to a sale or a contract entered into or awarded before October 1, 2001.

[66] See the summary for S.L. 2001-476 for a more complete explanation of this tax law change.

- Section 2 delays by one year the premiums tax equalization for HMOs and Medical Service Corporations, and makes up the revenue by one-time estimated payments and a slightly higher rate in 2003.
- Section 3 clarifies that prepared food is taxed the same under the Streamlined Sales and Use Tax Agreement, enacted earlier this session as S.L. 2001-347, as it was taxed under previous law. Section 3 also deletes part of a definition that would have inadvertently exempted alcoholic beverages served in restaurants from local meals taxes.

FISCAL IMPACT: No fiscal impact is expected as a result of the enactment of Section 1. Any refunds to be made are based on over collections that were not anticipated in S.L. 2001-424, the Appropriations Act

No fiscal impact is expected in FY 2001-02 as a result of Section 2 (premiums tax). The specifics of the new plan were designed in such a way that the new revenue produced for 2002-03 would be equal to the amount captured for that year under S.L. 2001-424. Thus this section is revenue neutral for 2002-03 with regard to the provisions adopted in that act. For future years it is difficult to determine the exact impact of either the prior change or the new provisions due to the uncertainty in the health insurance marketplace. For 2003-04 there might be a revenue loss (compared to S.L. 2001-424) due to the acceleration of estimated tax payments into 2002-03 to ensure revenue neutrality for that year.

Enactment of Section 3 in and of itself has no fiscal impact as it returns the definition to that anticipated in the original fiscal note for S.L. 2001-347. However, failure to enact this change would have resulted in a substantial revenue loss to the State by eliminating the State sales tax on all take-out, drive-thru, and delivery foodstuffs. Based on the 1997 Economic Census, Fiscal Research believes the minimum loss from not enacting this section of the act is as follows:

FY 2001-02	-	*$30.26 million*
FY 2002-03	-	*$62.84 million*
FY 2003-04	-	*$63.34 million*
FY 2004-05	-	*$65.72 million*
FY 2005-06	-	*$70.26 million*

This is only a minimum estimate as it does not include take-out from a full service restaurant or any other restaurant that is not primarily drive-thru, take-out, or delivery.

EFFECTIVE DATE: Section 1 and subsections a and b of section 2 became effective on December 19, 2001. Subsections f and g of Section 2 (premiums tax) are effective for taxable years beginning on or after January 1, 2004. The remainder of Section 2 is effective for taxable years beginning on or after January 1, 2003. Section 3 (prepared food) became effective January 1, 2002, and applies to sales made on or after that date.

ANALYSIS:

Motor Vehicle Transition

Section 1 of the act is a transitional provision regarding the repeal of the highway use tax cap on noncommercial vehicles. Section 34.24 of S.L. 2001-424 repealed the $1,500 highway use tax cap that applied to certificates of title issued for motor vehicles other than certain

commercial motor vehicles. This repeal became effective for certificates of title issued on or after October 1, 2001. The budget became law on September 26, 2001, only a few days before the repeal of the tax cap went into effect. Some motor vehicle dealers complained that they sold or contracted to sell vehicles, including expensive recreational vehicles, before October 1, 2001, but did not apply for the titles until after October 1. In these cases, they did not collect the additional tax from the purchaser but were liable to the State for the additional tax. Section 1 of this act provides that the repeal of the tax cap does not apply to titles issued as a result of a sale or a contract awarded or entered into before October 1, 2001.

Modify Taxation of HMOs and Medical Service Corporations

Section 2 of the act temporarily modifies the gross premiums tax on HMOs and Medical Service Companies. Section 34.22 of S.L. 2001-424 levied a gross premiums tax on HMOs and raised the rate of gross premiums tax on Medical Service Corporations. The rate for the 2002 tax year was to be 0.83% and the rate for 2003 and later tax years was to be 1%. Section 2 of the act changes that provision as follows:

- The tax changes are delayed from the 2002 tax year until the 2003 tax year.
- The tax rate for 2003 will be 1.1% and the tax rate for 2004 and later tax years will be 1%.
- For the 2003 tax year only, HMOs and Medical Service Corporations will pay the following estimated payments of the 2003 tax: 50% on April 15, 2003 and 50% on June 15, 2003, with true-up the following March 15. For subsequent tax years, the general law on installment payments of gross premiums tax will apply.

The HMO and medical service corporation industry requested this change because they had already sent their customers rate notices for the 2002 tax year that did not include the 0.83% rate for the 2002 tax year.

Clarify Sales Tax on Prepared Food and Meals Tax on Prepared Alcoholic Beverages

Under existing law, prepared foods that were prepared at a grocery store and sold in an unheated state were exempt from sales tax because they were eligible to be purchased for home consumption under the Federal Food Stamp Program. When the General Assembly enacted S.L. 2001-347, Streamlined Sales and Use Tax Agreement, it made the policy decision to tax candy, soft drinks, and prepared food in the same manner as under existing law. However, as the language in that act was drafted, some argued that it broadened the sales tax exemption for prepared food to include all take-out food items from restaurants and fast food chains and all catered food. These food items were taxable under existing law. An exemption for take-out food items would have resulted in a General Fund loss of approximately $60 million a year. Subsection 3(b) of this act rewrites the language in the Streamlined Sales and Use Tax Agreement to make it clear that only those food items that were exempt under existing law will be exempt under the Streamlined Sales and Use Tax Agreement.

In addition, under existing law, local meals taxes applied to the entire meal, including alcoholic beverages. When the definition of food was rewritten in S.L. 2001-347 the definition excluded alcoholic beverages because, for sales tax purposes, alcoholic beverages were not entitled to the food tax exemption. Because local meals tax laws were linked to the sales tax definitions, prepared alcoholic beverages (beer, wine, mixed drinks) would have been inadvertently exempted from local meals taxes effective January 1, 2002. Section 3 maintains the existing law by providing that local meals tax continues to apply to alcoholic beverages. The following

local governments have a meals tax: Cumberland County; Dare County; Mecklenburg County; Wake County; Town of Hillsborough

Modify Vehicle Tax Refund & Tax Cap

Session Law #	*Bill #*	*Sponsor*
S.L. 2001-497	**HB 72**	**Representative Allred**

AN ACT TO EXTEND THE DEADLINE FOR APPLYING FOR A RELEASE OR REFUND OF PROPERTY TAXES AFTER THE OWNER HAS SURRENDERED THE VEHICLE LICENSE PLATE, AND TO CAP THE HIGHWAY USE TAX ON CERTAIN RECREATIONAL VEHICLES AT $1,500 PER VEHICLE.

OVERVIEW: This act does two things:

- It extends from 120 days to one year the time a taxpayer has to request a refund for property taxes paid on a motor vehicle for which the taxpayer has surrendered the vehicle's registration plate.
- It places a maximum highway use tax of $1,500 on recreational vehicles that do not qualify for the existing $1,000 maximum tax.

FISCAL IMPACT: Due to a lack of data, the General Assembly's Fiscal Research Division cannot determine how many taxpayers do not file for the refund and/or release once the plates are surrendered or what proportion of those taxpayers who did not apply will apply under the extended timeline. As such, no formal estimate is possible. However, both the Division of Motor Vehicles and Fiscal Research believe the number of taxpayers that will take advantage of the deadline extension will be insignificant.

Based on sales data from the years 2000 and 2001 from 3 high volume RV dealerships, the total revenue gained from removing the $1,500 highway use tax cap on recreational vehicles is $842,811 in a full year. Passage of this bill for the nine months in FY 2001-02 will result in the loss of $632,000 to the Highway Trust Fund. The loss occurs because the anticipated gain from removing the cap in S.L. 2001-424 was transferred to the General Fund. While the cap was restored for recreational vehicles in this act, the General Fund transfer has not been reduced.

Applying the growth rates projected by the Office of State Budget and Management for the highway use tax, the future revenue loss is a follows:

Fiscal Year	Revenue
FY 2001-02	$ 632,000
FY 2002-03	$ 908,550
FY 2003-04	$ 961,246
FY 2004-05	$1,016,037
FY 2005-06	$1,068,871

EFFECTIVE DATE: The effective date of the extension of the deadline for requesting a refund was December 19, 2001. The effective date for the reapplication of the $1,500 cap on the highway use tax is retroactive to October 1, 2001

ANALYSIS:

Property Tax Change

An owner of a motor vehicle who a) either transfers the motor vehicle to another owner or moves out-of-state and registers the vehicle in another jurisdiction, and b) surrenders the registration plates from the vehicle to the Division of Motor Vehicles may apply for a release or refund of taxes on the vehicle for the full calendar months that remain in the vehicle's tax year. In 1995, the General Assembly extended the time period to apply for this refund or release to 120 days to give the taxpayer sufficient time to ask for a release or refund of taxes after the taxpayer received a property tax bill. This time period appeared to be sufficient except in instances where the tax bill was received late for some reason. Section 1 of this act extends the period of time a taxpayer has to request a refund for property taxes paid on a motor vehicle for which the taxpayer has surrendered the vehicle's registration plate from 120 days to one year.

A taxpayer who has a valid defense to a tax also has the ability to ask for a refund of a property tax at any time within five years after the tax first became due or within six months from the date the tax was paid, whichever is the later date. This time period is the same for real property, personal property, and motor vehicles. There are three valid defenses to the enforcement of the collection of a tax assessed upon property:

- The tax is imposed through clerical error.
- The tax is levied for an illegal purpose.
- The tax is an illegal tax.

The board of county commissioners holds the county tax collector accountable for the amount of taxes collected. Unpaid taxes on motor vehicles are often collected when DMV refuses to renew the vehicle's registration until the taxes are paid. The unpaid taxes may also be collected through the enforcement measures of levy, attachment, and garnishment. The tax collector has 10 years from the date the property taxes become due to begin enforcement proceedings. This statute of limitations is the same for all types of property. If the tax is uncollectible because the taxpayer is insolvent, the board of county commissioners may, in its discretion, relieve the tax collector of the responsibility of collecting the tax if the tax is five or more years past due. This time period is shortened to one year for motor vehicles when the board finds that the taxes are uncollectible.

Highway Use Tax Change

Section 34.24 of the Current Operations and Appropriations Act, S.L. 2001-424, repealed the $1,500 highway use tax cap that applied to certificates of title issued for motor vehicles other than certain commercial motor vehicles. Class A and Class B commercial motor vehicles are subject to a $1,000 highway use tax cap. The Attorney General's office has written a letter indicating that recreational vehicles that weigh more than 26,000 pounds qualify as Class B commercial motor vehicles, and so are subject to the $1,000 tax cap. Section 2 of this act restores a $1,500 Highway Use Tax cap for lighter recreational vehicles, which are not subject to the $1,000 cap because they do not qualify as commercial vehicles. Section 2 is effective retroactively to October 1, 2001, so that a $1,500 cap applies to non-commercial recreational

vehicles both before and after the removal of the $1,500 tax cap for other vehicles. The maximum tax of $1,500 on certain recreational vehicles means that a vehicle valued at over $50,000 does not pay the highway use tax at a full 3% rate because the cap is reached once the vehicle's value reaches $50,000.

Amend Use Value Statutes

Session Law #	Bill #	*Sponsor*
S.L. 2001-499	**HB 1427**	**Agriculture Committee**

AN ACT TO AMEND THE PRESENT-USE VALUE STATUTES AND TO ESTABLISH THE PROPERTY TAX STUDY COMMISSION.

OVERVIEW: The act makes two changes to the present-use value statutes:

- It provides that the owner of land classified as agricultural land, horticultural land, or forestland can transfer the property, regardless of whether the new owner already has property in the classification, without losing the property's use value tax status.
- It allows the owner of land classified as agricultural land, horticultural land, or forestland to prepay any deferred taxes that are lien on the property.

The act also authorizes a Property Tax Study Commission.

FISCAL IMPACT: There is no General Fund impact due to this act. The estimated fiscal impact to local governments cannot be determined.

EFFECTIVE DATE: January 1, 2002.

BACKGROUND: Property tax law provides that unless property is exempted or classified for special tax treatment, it is to be taxed at its market value. Agricultural land, horticultural land, and forestland may be classified as a special class of property and taxed at their value in the land's present use as agricultural land, horticultural land, or forestland. The special classification for farm property was enacted in the 1970s to help preserve family farms. The difference between the taxes due on the present use value treatment and the taxes that would have been payable in the absence of this special treatment, together with any interest, penalties, or costs, are a lien on the property. The difference in taxes is carried forward in the records of the taxing unit as deferred taxes. The deferred taxes for the preceding three years become payable whenever the property loses its eligibility for the benefit of the special use value law.

ANALYSIS: Section 1 of the act expands the applicability of the use-value program to farmer-to-farmer transfers. Under current law, the property must be the owner's residence on have been owned by the person for four years before the property can be classified in the use-value program. When an owner transfers property to a person who does not qualify for the use-value program, then the previous owner is responsible for paying the deferred taxes. Prior to the act, there was an exception to the four-year ownership requirement, if the new owner owned other property classified in the use-value program. In this situation, the deferred taxes would still be due but the property could immediately qualify for use value in the hands of the new owner. Section 1 expands this exception in two ways. First, it removes the requirement that the new owner have other property classified in the use-value program. However, the new owner must acquire the land for the purposes of and continue to use the land for the purposes

it was classified under the use-value program. Second, the deferred taxes d not become due; instead, the new owner is liable for the deferred taxes. The years of deferred taxes, plus the current year's taxes including interest and penalties, on the classified property become due when the property no longer qualifies for the classification.

Section 2 of the act clarifies that a person may pay the deferred taxes for any given year for that year without the qualifying land becoming ineligible for use-value status. This prepayment of deferred taxes may be a helpful planning tool for a person who is planning to transfer the land in the near future to a person who does not meet the ownership requirements or to use the land in the future in a way that does not meet the use requirements.

Section 3 of the act establishes the Property Tax Study Commission. Both the Speaker of the House and the President Pro Tempore of the Senate may appoint eight members each: four legislative members and four public members. The Committee may submit a report to the 2002 Regular Session and must submit a report on or before the convening of the 2003 Session. The Committee may study all of the following issues:

General Property Tax Issues

Examine all classifications of property, including the taxability of nonprofit charitable hospitals, as well as other exemptions and exclusions of property from the property tax base.

Present-Use Value Issues

Study the present-use value system, including the following:

- Examine the implementation and application of the current use value statutes
- Evaluate other tax credits, including adjustments to and credits for ad valorem taxes, to encourage agricultural, forestry, and horticultural use of land.
- Evaluate the treatment of undeveloped land in ad valorem tax.
- Evaluate the possibility of tax incentives to encourage conservation and environmental protection of land. The study must include the feasibility of allowing forestland managed for conservation purposes and the preservation of wildlife habitats to be taxed at its present-use value.
- Review other issues related to the taxation of agricultural, horticultural, and forestland, including reducing the acreage requirement for land to qualify as forestland.

Certain Manufactured Homes Real Property

Session Law #	Bill #	*Sponsor*
S.L. 2001-506	**HB 253**	**Representative Brubaker**

AN ACT TO PROVIDE THAT MANUFACTURED HOMES NEED NOT HAVE MULTIPLE SECTIONS TO QUALIFY AS REAL PROPERTY FOR PROPERTY TAX PURPOSES, TO REQUIRE AN OWNER TO SURRENDER CERTIFICATE OF TITLE WHEN THE MANUFACTURED HOME BECOMES REAL PROPERTY, AND TO REQUIRE AN OWNER TO FILE EVIDENCE OF THE SURRENDER OF TITLE WITH THE REGISTER OF DEEDS.

OVERVIEW: The act makes the following changes to the laws regarding the classification of a manufactured home as real property:

- Amends the definition of "real property" in the property tax laws by removing the requirement that a manufactured home must have multiple sections to be considered real property.
- Codifies the current policy of the Division of Motor Vehicles (DMV) requiring an owner of a manufactured home to submit an affidavit and surrender the certificate of title to DMV when the manufactured home becomes real property under the property tax laws.
- Requires the owner of real property who has surrendered the certificate of title to a manufactured home on the real property and submitted an affidavit to DMV to then file the returned affidavit in the officer of the register of deeds where the property is located.
- Allows the owner of real property on which an untitled manufactured home has been or will be placed to file a declaration of intent to place a manufactured home on the real property and to convey or encumber the real property, including the manufactured home.

FISCAL IMPACT: There is no General Fund impact due to this act. The fiscal impact to local governments cannot be determined.

EFFECTIVE DATE: The change to the definition of "real property" in the property tax laws is effective for taxes imposed for taxable years beginning on or after July 1, 2002. The remainder of the act became effective January 1, 2002, and applies to manufactured home title cancellations and to declarations of intent, deeds, deeds of trust, and other instruments recorded after that date.

BACKGROUND: Since 1987, North Carolina law has provided that a residential manufactured home constitutes "real property" for property tax purposes if it meets the following requirements: is multi-sectioned (two or more sections); has the moving hitch, wheels, and axles removed; and has been placed on a permanent foundation on land owned by the owner of the home. Manufactured homes, in many cases, are titled by DMV through the issuance of a certificate of title. When a home is treated as real property for property tax purposes, the owner will often apply to DMV to cancel the title, as the financing may be obtained through a real estate mortgage recorded in the local register of deeds office, rather than a personal property lien reflected on the title. DMV has developed an informal procedure for canceling these titles upon the owner's request, and with the consent of the lender. DMV, the manufactured housing industry, mortgage lenders, title insurance companies, and real estate closing attorneys have been interested in clarifying this procedure and enacting it into law. This act codifies and clarifies the procedure.

ANALYSIS: Under prior law, the tax assessor was to consider the manufactured home as real property for property tax purposes if it was a multi-section residential structure; had the moving hitch, wheels, and axles removed; and was placed upon a permanent enclosed foundation on land owned by the owner of the home. Section 1 removes the multi-section requirement from the definition of "real property" in G.S. 105-273. Section 1 also clarifies that a residential manufactured home will be considered tangible personal property if the moving hitch, wheels, and axles are still intact, and the home has not been placed on a permanent foundation on land owned by the owner of the home. This change will allow for a more uniform procedure for determining whether a manufactured home is real or personal property for tax purposes.

Section 2 of the act codifies the current policy of the DMV to require an owner of a manufactured home to submit an affidavit and surrender the certificate of title to DMV when the manufactured home meets the definition of real property under G.S. 105-273. The affidavit must contain information of the manufacturer, vehicle identification number and serial number of the home, legal description of the property on which the home is placed, any security interests in the home, and the Division's notation that the title has been surrendered and cancelled. After canceling the title, DMV must return the original affidavit to the owner. The owner must then file the affidavit in the office of the register of deeds where the owner's real property is located. Section 2 also provides for a procedure to apply for a new certificate of title if the owner later seeks to remove the manufactured home from the real property. A violation of section 2 is a civil penalty of up to $100 to be imposed in the discretion of the Commissioner of Motor Vehicles. This change was enacted to prevent manufactured home owners from attempting to have their homes assessed as personal property once the homes became affixed to the owner's real property and met the other requirements of "real property" in G.S. 105-273.

Sections 3 and 4 of the act, add new provisions to Chapter 47 (Probate and Registration) of the General Statutes regarding filing documents with the register of deeds when a manufactured home becomes attached to real property or will become attached to real property. Section 3 requires an owner of real property who has filed an affidavit and surrendered a certificate of title to a manufactured home on the real property to DMV, to then file the returned affidavit with the office of the register of deeds. Once this affidavit is recorded, the manufactured home is considered an improvement to real property, and all existing liens on the real property are considered to include the manufactured home.

Section 4 of the act adds a provision to Chapter 47 that allows the owner of real property on which an untitled manufactured home has or will be placed to file a declaration of intent to place a manufactured home on the real property and to convey or encumber the real property, including the manufactured home. A manufactured home may not have been titled in a situation where there is a new manufactured home and the buyer and seller intend for the home to be located on a permanent foundation and sold and financed as a real estate transaction. Section 4 allows the owner of the real property to record a declaration of intent that contains the same information that would be required in an affidavit submitted to DMV if that home had been previously titled. Upon filing of the declaration of intent, the manufactured home is treated as an improvement to the real property. Therefore, all liens or mortgages against the real property will include the manufactured home.

Corporate Asset Transfers

Session Law #	*Bill #*	*Sponsor*
S.L. 2001-508	**HB 168**	**Representative Culpepper**

AN ACT TO PERMIT A CORPORATION TO TRANSFER ASSETS TO A WHOLLY OWNED UNINCORPORATED ENTITY, AS RECOMMENDED BY THE GENERAL STATUTES COMMISSION, TO AMEND THE INDEMNIFICATION PROVISIONS OF THE PATIENT'S BILL OF RIGHTS, TO SUPPORT TROOPS PARTICIPATING IN OPERATIONS ENDURING FREEDOM AND NOBLE EAGLE, AND TO PERMIT LEAVE FOR DISASTER SERVICE VOLUNTEERS.

OVERVIEW: This act makes the changes listed below. This summary addresses in detail only those provisions of the act that affect the tax laws.

- Permits the board of directors of a corporation to transfer corporate assets to a wholly owned limited liability company, limited partnership, registered limited liability partnership, or other unincorporated entity without the approval of the shareholders. (Section 1)
- Amends the indemnification provisions of the Patient's Bill of Rights. (Section 2)
- Supports troops participating in Operations Enduring Freedom and Noble Eagle by authorizing the Governor to waive deadlines, fees, and penalties; extending applicable deadlines for paying property taxes and listing property for taxation; and allowing community college and UNC system refunds and waiver of legislative tuition grants to deployed students who are unable to complete the semester. (Sections 3 – 5 and 7 – 9)
- Permits State agencies to grant State employees who are certified Red Cross volunteers paid leave from work to assist with disaster relief. Under prior law, leave was permitted only for services related to a disaster occurring with the State. The act permits paid leave to employees providing services related to a disaster occurring anywhere within the United States. (Section 6)

FISCAL IMPACT: Under certain circumstances, there could be tax advantages to transferring corporate assets to an unincorporated entity. However, many of these potential tax advantages were removed with the enactment of S.L. 2001-327. As a result, the North Carolina Department of Revenue does not believe passage of this legislation, in and of itself, will substantially affect State revenue. While there is a potential for a fiscal loss as an indirect consequence of the act, that impact is expected to be minimal. No estimates were available on the fiscal impact of the remaining sections of the act.

EFFECTIVE DATE: Section 2 (indemnification rights) is effective July 1, 2002; the remainder of the act became effective on December 19, 2001, the date the bill became law. Section 1 of the act applies to transfers occurring on or after that date.

ANALYSIS:

Corporate Asset Transfers

Section 1 of this act expands the types of entities to which the board of directors of a corporation can transfer corporate assets without shareholder approval to include wholly owned unincorporated entities. The term "unincorporated entity" is defined in the North Carolina Business Corporation Act to mean domestic or foreign limited liability companies, domestic or foreign limited partnerships, registered limited liability partnerships, and other partnerships. The articles of incorporation or the bylaws of the parent company could still prohibit such a transfer. This section was a recommendation of the General Statutes Study Commission.

Support Troops/Civil Relief

Section 5 of this act extends property tax deadlines for military personnel called to active duty as a result of the terrorist attacks on September 11, 2001. Section 5(a) provides that these individuals are allowed 90 days after the end of their deployment to pay property taxes that became due or delinquent during the deployment. If the taxes are paid within this 90-day period, no interest is due. Section 5(b) of the act provides that deployed military personnel are allowed 90 days after the end of their deployment to list for taxation property that was otherwise required to be listed during their deployment. If the property is listed within this 90-day period, no penalties for failure to list apply.

No Tax on Newspapers Sold in Vending Machines

Session Law #	*Bill #*	*Sponsor*
S.L. 2001-509	**SB 400**	**Senator Hoyle**

AN ACT TO TREAT NEWSPAPER VENDING MACHINES AS STREET VENDORS FOR SALES TAX PURPOSES.

OVERVIEW: This act exempts all sales of newspapers sold through vending machines from sales and use tax.

FISCAL IMPACT: Data are not available to estimate the fiscal impact of this act. However, it is expected the impact of this act will be relatively small given the limited number of papers sold through stand alone machines and the fact that all vending machine sales that were primarily taxable were subject to only 50% of the tax rate.[67]

EFFECTIVE DATE: January 1, 2002.

ANALYSIS: This act exempts all sales of newspapers through vending machines from sales and use tax. Confusion had arisen about the tax status of newspapers sold through vending machines at convenience stores, shopping areas, and malls. This act simplifies the taxation issue by exempting all sales of newspapers sold through vending machines.

Newspapers sold by a street vendor are specifically exempt from sales and use tax. Prior to January 1, 2002, the taxability of newspapers sold through vending machines depended upon whether the vending machine could be considered analogous to a "street vendor". Under the Department of Revenue's longstanding interpretation of the law, vending machines located in public areas, such as shopping centers and malls, airport terminals, train stations, bus stations, and other locations that were not inside or on the premises of a store or business, were considered a form of "street vendor". As such, the sale of newspapers through those machines was exempt from tax. However, newspapers sold through vending machines located inside or on the premises of a store or business were not considered analogous to a "street vendor" and therefore those sales were subject to tax.

The issue became more pronounced when the Department of Revenue began to consider the sale of newspapers through vending machines located inside or on the premises of a business in its sales tax audits of those businesses. As a result of the confusion on this issue, the Department agreed not to pursue any of these taxes before April 1, 2001, and not to attempt to collect back taxes prior to this date.

Tax Revenue for Turfgrass Research

Session Law #	*Bill #*	*Sponsor*
S.L. 2001-514	**HB 688**	**Representative Gibson**

AN ACT TO TAX THE SALES OF FERTILIZERS AND SEED TO NONFARMERS AND TO APPROPRIATE REVENUES FOR TURFGRASS RESEARCH AND EDUCATION AND THE SAVINGS RESERVE ACCOUNT.

[67] G.S. 105-164.13(50).

OVERVIEW: This act does three things:

- It imposes a 6.5% State and local sales tax on fertilizers and seed sold to consumers other than farmers.
- It appropriates $700,000 from the General Fund for each year in the 2001-03 biennium budget for turfgrass research and education.
- It credits $750,000 from the General Fund to the Savings Reserve Account in fiscal year 2001-02.

FISCAL IMPACT: The fiscal impact of the act is as follows:

	FY 2001-02	*FY 2002-03*	*FY 2003-04*	*FY 2004-05*	*FY 2005-06*
General Fund	$2,305,937	$6,271,702	$5,745,039	$5,867,577	$5,990,116
NCSU	(600,000)	(600,000)			
Dept. of Ag.	(100,000)	(100,000)			
Savings Res.	(750,000)	-	-	-	-
Net General Fund	$855,937	$5,571,702	$5,745,039	$5,867,577	$5,990,116

EFFECTIVE DATE: The act is effective February 1, 2002.

ANALYSIS: This act imposes the 6.5% State and local sales tax on seeds and fertilizers sold to non-farmers.[68] Prior to the enactment of this act, fertilizers used for agricultural purposes and seeds were not subject to State or local sales tax. The General Assembly enacted this exemption when farmers primarily used these items. Today, non-farmers purchase an increasing volume of these items.

The act appropriates $700,000 from the General Fund for each of the two fiscal years in this biennium for turfgrass research and education. Of this amount, $600,000 is appropriated to The University of North Carolina to be allocated to North Carolina State University (NCSU). The remaining $100,000 is appropriated to the Department of Agriculture and Consumer Services for the purpose of educating the public on the results of the research conducted by the Center for Turfgrass Environmental Research and Education at NCSU.

NCSU estimates that it needs approximately $1,000,000 annually to support current turfgrass research at the University. It has not received an appropriation of more than $200,000 for this purpose. This act provides $600,000 for this funding need. The remaining $400,000 will come from the turfgrass industry and other private sources.

NCSU approved the establishment of the Center for Turfgrass Environmental Research and Education in March 2001. The Center will be the focus of turfgrass research activities at NCSU. It will be established as a partnership with the North Carolina turfgrass industry and serve a key educational role in communicating with the turfgrass community and the general public. The Center will be the first of its kind; one of its goals is to position the Turfgrass Program in North Carolina at the forefront of turfgrass research and education in the United States.

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[68] The Governor's Loophole Study Commission and the Governor recommended this provision to the General Assembly. The Senate included it as one of its revenue raising items in its budget bill, the 3rd Edition of SB 1005.

A faculty member at NCSU will serve as the Director of the Center. The Director will coordinate research and on-site extension activities. An "Industry Advisory Board" will meet annually to review research and outreach efforts and offer suggestions on focus, impact, and directions for the new program. The Board will set priorities and make decisions on project funding. The Board will be composed of leaders in the turfgrass industry. This act specifies that the Board must include representatives from NCSU and NC A&T University. The Board may receive requests for funding proposals from both NCSU and NC A&T University.

The act provides that the Board of Governors and the Commissioner of Agriculture must report to the Joint Legislative Commission on Governmental Operations and to the Fiscal Research Division by November 1, 2002, on the use of the funds allocated to the Center for Turfgrass Education and Research and the sharing of the research with the other constituent institutions.

Lastly, the act requires the State Controller to credit $750,000 from the General Fund to the Savings Reserve Account by June 30, 2002. The Savings Reserve Account is a restricted reserve in the General Fund. The funds in the Savings Reserve Account cannot be used unless the use has been approved by an act of the General Assembly.

EXTEND SUNSET ON STATE PORTS TAX CREDIT

Session Law	*Bill #*	*Sponsor*
S.L. 2001-517	**HB 1388**	**Representative Hurley**

AN ACT TO EXTEND THE SUNSET ON THE STATE PORTS TAX CREDIT.

OVERVIEW: This act extends the sunset on the credit for North Carolina State Ports Authority wharfage, handling, and throughput charges to January 1, 2003.

FISCAL IMPACT: The act is expected to reduce General Fund revenues $657,000 annually.

EFFECTIVE DATE: The bill is effective for taxable years beginning on or after March 2, 2000. The bill is effective retroactive to March 2, 2000, so that the availability of the credit remains uninterrupted.

ANALYSIS: This act extends the sunset on the State Ports tax credit an additional 34 months. Before the enactment of this act, the credit expired for tax years ending on or before February 28, 2001.

The State Ports Authority tax credit is allowed to a taxpayer who loads or unloads waterborne cargo from an ocean carrier at the State-owned port terminal at Wilmington or Morehead City. The credit is allowed against the taxpayer's income tax. The taxpayer may be either an individual (G.S. 105-151.22) or a corporation (G.S. 105-130.41). The amount of the tax credit is equal to the amount of wharfage, handling, and throughput charges paid to the North Carolina State Ports Authority in the taxable year that exceeds the average amount of charges paid to the Authority for the current tax year and the two previous tax years. The credit is limited to 50% of the tax imposed on the taxpayer for the taxable year. Any excess credit may be carried forward and applied to the taxpayer's income tax liability for the next five years. The maximum cumulative credit that one taxpayer may claim is $2 million.

In 1992, the General Assembly enacted the State Ports income tax credit to encourage exporters to use the two State-owned port terminals at Wilmington and Morehead City. When enacted, the credit applied to amounts paid by a taxpayer on any cargo exported at either

port. In 1994, the General Assembly expanded the credit to include all amounts assessed on exported cargo, regardless of who paid the shipping costs. In 1995, the General Assembly expanded the credit to include some imports by allowing a credit for break-bulk cargo and container cargo imported at either Wilmington or Morehead City and for bulk cargo imported at Morehead City. It did not allow a credit for bulk cargo imported at Wilmington. In addition, the credit for bulk exports was then limited to bulk exports at only the Morehead City terminal. In 1996, the General Assembly expanded the State ports income tax credit to include the importing and exporting at either terminal of one specific type of bulk cargo: forest products. All imports and exports of bulk cargo at the Morehead City terminal were already covered, so the effect of this change was to allow a credit for forest product imports and exports at the Wilmington terminal. In 1997, the General Assembly extended the sunset of the State ports income tax credit from February 28, 1998 to the taxable year ending on or before February 28, 2001, and increased the maximum cumulative credit from $1 million to $2 million per taxpayer. This increase became effective for taxable years beginning on or after January 1, 1998.

Although not defined by the relevant statutes, the various types of cargo differ as follows:

- Bulk cargo is a type of commodity that is loose and usually stockpiled. Examples of this type of commodity include coal, grain, salt, and wood chips.
- Break-bulk cargo consists of commodities that are packaged and stored on pallets or in cases that must be handled and stacked onto a ship by hand, crane, etc. Break-bulk cargo also includes machinery,
- Container cargo consists of commodities that are packaged in a metal trailer box that can be locked onto a tractor-trailer chassis and then detached and put on a ship without any other handling.

2000

REFORM LOCAL TAX ON RENTAL CARS

Session Law #	Bill #	Sponsor
S.L. 2000-2	SB 1076	Senator Cooper

AN ACT TO REPEAL THE PROPERTY TAX ON CERTAIN VEHICLES LEASED OR RENTED UNDER RETAIL SHORT-TERM LEASES OR RENTALS AND TO REPLACE THE TAX REVENUE WITH A LOCAL TAX ON GROSS RECEIPTS DERIVED FROM RETAIL SHORT-TERM LEASES OR RENTALS.

OVERVIEW: This act repeals the property tax on vehicles owned and offered for short-term rental by someone engaged in the business of renting vehicles to the public, and enacts in its place local option county and city gross receipts taxes on short-term vehicle rentals.[1]

FISCAL IMPACT: There is no General Fund or Highway Fund impact. The property tax exemption will result in an annual loss to local governments of at least $5.6 million. Because the county and city gross receipts taxes are local option, it is not known how much revenue they would generate.

EFFECTIVE DATE: July 1, 2000.

BACKGROUND & ANALYSIS: This act excludes from property tax vehicles[2] that are offered at retail for short-term lease or rental, if the vehicle is owned or leased by an entity engaged in the business of leasing vehicles short-term to the general public. A short-term lease or rental is a lease or rental for fewer than 365 continuous days. Under prior law, rental car businesses paid property taxes on their vehicle inventory.

The act replaces the property tax on short-term rental inventory with a local option gross receipts tax. Long-term rental inventory remains subject to property tax. In order to recover its revenue lost due to the property tax exclusion, each county and each city may levy a gross receipts tax of up to 1.5% on short-term vehicle rentals. A vehicle is defined as any of the following:

- A passenger-type vehicle (including vans and sports utility vehicles).
- A cargo-type vehicle other than (1) a truck over 26,000 pounds, (2) a truck used to transport commercial freight, or (3) a truck that requires the driver to have a commercial drivers license.
- A trailer or semitrailer under 6,000 pounds.

The tax would be collected and retained by the taxing city or taxing county and would apply to agreements under which the customer takes possession of the vehicle in the taxing city or

[1] Technical corrections were made to this act by S.L. 2000-140.
[2] The term "vehicle" is not defined for purposes of the property tax exclusion.

county. The taxing city or county would administer the local gross receipts tax in the same manner as the sales tax and the alternate highway use tax on rental vehicles. The taxing city or county would have the same collection powers that the Secretary of Revenue has in collecting local sales taxes, and the same penalties and remedies would apply. The act provides that the tax will be passed on to the customer. The lease or rental agreement must specify the rate of the local gross receipts tax being charged.

The act requires the Fiscal Research Division to determine the total amount of revenue generated by local gross receipts taxes authorized by the act and compare that to the total amount of ad valorem taxes that would have been generated if the act had not excluded short-term rental vehicles. The Fiscal Research Division must report its findings to the 2003 session.

BONDS FOR HIGHER EDUCATION

Session Law #	Bill #	Sponsor
S.L. 2000-3	**SB 912**	**Senator Rand**

AN ACT TO (1) TO AUTHORIZE THE ISSUANCE OF THREE BILLION ONE HUNDRED MILLION DOLLARS GENERAL OBLIGATION BONDS OF THE STATE, SUBJECT TO A VOTE OF THE QUALIFIED VOTERS OF THE STATE, TO PROVIDE FUNDS FOR CAPITAL IMPROVEMENTS FOR THE UNIVERSITY OF NORTH CAROLINA AND GRANTS TO COMMUNITY COLLEGES FOR CAPITAL IMPROVEMENTS AND (2) TO AUTHORIZE THE BOARD OF GOVERNORS OF THE UNIVERSITY OF NORTH CAROLINA TO ISSUE SPECIAL OBLIGATION BONDS FOR IMPROVEMENTS TO THE FACILITIES OF THE UNIVERSITY OF NORTH CAROLINA AND FOR THE UNIVERSITY OF NORTH CAROLINA HOSPITALS AT CHAPEL HILL AND OTHER FACILITIES OF THE UNIVERSITY OF NORTH CAROLINA HEALTH CARE SYSTEM.

OVERVIEW: This act known as the Michael K. Hooker Higher Education Facilities Finance Act, creates a new Chapter 116D of the General Statutes to establish the following mechanisms for debt financing of higher education facilities:

- It authorizes the State to issue general obligation bonds to finance $2.5 billion of capital facilities for the University of North Carolina and $600 million of capital facilities for community colleges. The bonds would be subject to approval by the voters in the November 2000 statewide general election.
- It authorizes the UNC Board of Governors to issue special obligation bonds to finance capital facilities for the University. The University's receipts other than tuition or appropriations from the General Fund would secure the bonds. S.L. 2000-168 sets forth the first projects that will be funded by special obligation bonds.

FISCAL IMPACT: The act limits the maximum amount of general obligation bonds that may be issued each year for the next six fiscal years. The debt service costs paid from the State General Fund will be $28.7 million for fiscal year 2001-2002, increasing to $194.9 million by fiscal year 2004-2005.

EFFECTIVE DATE: The act became effective May 25, 2000.

BACKGROUND & ANALYSIS: Eva Klein, consultant to the Board of Governors for the study of the equity and adequacy of capital facilities, prepared a report detailing the deterioration of the current facilities of The University of North Carolina. In response to this report, the General

Assembly began considering a significant bond proposal in 1999. The Speaker and the President Pro Tempore appointed a conference committee towards the end of the 1999 Session to consider the differences between the houses on the bond bill. During the interim, a Joint Select Committee on Higher Education Facilities Needs met and toured various campuses within the University of North Carolina and the North Carolina Community College System. Shortly after the convening of the 2000 Session, the General Assembly enacted this act.

This act creates two different funding mechanisms to finance higher education facilities. First, it authorizes the State to issue $3.1 billion of general obligation bonds to finance capital facilities for the University of North Carolina and for community colleges. The voters in the November 2000 statewide general election must approve the bonds before they may be issued. The UNC projects that can be financed with the bond revenues are set out in this act. Second, it authorizes the UNC Board of Governors to issue special obligation bonds to finance capital facilities for the University. The bonds would not be subject to a referendum because they are not secured by the taxing power of the State. The University's receipts other than tuition or appropriations from the General Fund would secure the bonds. Although this act does not authorize any particular projects, S.L. 2000-168 gives legislative approval for at least one project financed with special obligation bond revenues. The act also imposes reporting requirements to allow the General Assembly to monitor all aspects of the proposed bonds.

General Obligation Bonds

Article 2 of the new Chapter 116D created by this act authorizes the State to issue university improvement general obligation bonds to acquire, construct, and improve University property and Article 4 of the new Chapter 116D authorizes the State to issue community college general obligation bonds to acquire, construct, and improve community college property. Both bonds must be approved by the voters of the State in a single ballot question in November 2000. If a majority of those voting on the question do not approve the bonds, neither the UNC bonds nor the Community College bonds can be issued.

The university improvement general obligation bonds would be used for construction, improvement, and acquisition of capital facilities for constituent and affiliated institutions of The University of North Carolina, including the Center for Public Television, the UNC Health Care System, the School of Science and Mathematics, and the North Carolina Arboretum. Similarly, the community college general obligation bonds would be used for grants to community colleges for construction, improvement, and acquisition of their capital facilities. The act specifically defines capital facilities as buildings, utilities, structures, and other facilities and property developments, including streets, landscaping, equipment, and furnishings in connection with a building project, and land acquisition. The facilities may include physical education facilities, housing, and administrative offices as well as educational buildings.

The bonds would be issuable by the Treasurer only to fund allocations established by the General Assembly; those allocations are set out in this act. The act limits the amount of bonds that may be issued each year over six years as follows:

FISCAL YEAR	UNIVERSITY	COMMUNITY COLLEGES
2000-2001	$201,600,000	$ 48,400,000
2001-2002	241,900,000	58,100,000

2002-2003	483,900,000	116,100,000
2003-2004	483,900,000	116,100,000
2004-2005	564,500,000	135,500,000
2005-2006	$524,200,000	$125,800,000

The full faith and credit and the taxing power of the State would secure the proposed general obligation bonds; a statement to this effect would appear on the face of the bonds. These general obligation bonds would be repaid from the General Fund. The maximum maturity on the bonds would be 25 years.

The allocations established in the act include a $25 million reserve for repair and renovations and cost overruns. If the cost of a project changed, the Board of Governors could reallocate funds from one project to another, but only between projects at the same institution. The act states the intent of the General Assembly that the repairs and renovations shall preserve the historical and architectural fabric of the buildings.

The act also sets out the amount allocated to sites at each community college for new construction and for repairs and renovations and requires that the allocations must be used in accordance with the State Board of Community Colleges' funding formulas for new construction needs and repair and renovation needs at each community college. A community college could reallocate to another site new construction funds that the consultant's report allocates to a specific site only if (1) the community college finds that the funds are not needed at the site for which the report allocates them and (2) the State Board approves the reallocation, except that funds allocated to a site away from the main campus county may not be reallocated back to the main campus county. Bond proceeds allocated for repair and renovations could be used only for repair and renovations, but bond proceeds allocated for new construction could be used either for new construction or for repair and renovations. The local board of trustees is directed to allocate repair and renovation funds in accordance with need, subject to approval by the State Board of Community Colleges.

Under general law, community colleges are required to match State capital funds on a dollar-for-dollar basis. The act provides three limited exceptions to this requirement for the bond proceeds. First, bond proceeds allocated for repair and renovations need not be matched. Second, community colleges that the consultant's report determined had a matching ability of less than 40%, based on ability to pay, need not match allocations for new construction. Third, community colleges which the consultant's report determined had a matching ability of 40% or more must match new construction allocations only at the matching ability percentage assigned to them in the report. If any community colleges could not meet their matching requirements by July 1, 2006, the funds that were not matched would be pooled and reallocated among those community colleges that had met their requirements, based on capital improvement needs determined by the State Board of Community Colleges.

Under current law, a community college project in the amount of $100,000 or more is subject to approval and supervision by the State Construction Office under G.S. 143-341. An exception created under this act limits the approval and supervision requirement for bond-funded projects to those that exceed $250,000.

UNC Special Obligation Bonds

Article 3 of the new Chapter 116D created by this act authorizes the UNC Board of Governors to issue a second type of self-liquidating bonds, known as special obligation bonds. Prior to the enactment of this act, the Board of Governors could issue revenue bonds. Revenue bonds are payable from rentals, charges, fees, and other revenues, such as gifts. This act broadens the authority of the Board by allowing it to issue special obligation bonds payable with any sources of income or receipts of the Board of Governors or a constituent or affiliated institution, but not including tuition payments or appropriations from the General Fund. Special obligation bond proceeds may be used for construction, improvement, and acquisition of any capital facilities located at UNC constituent and affiliated institutions. The maximum maturity on the bonds is 25 years.

Special obligation bonds are not general obligation bonds and thus are not required to be approved by the voters. The full faith and credit or the taxing power of the State does not secure them and a statement to this effect would appear on the face of the bonds. Property could not be pledged to secure the bonds. The Board of Governors' pledge of obligated resources would secure the bonds. Obligated resources, defined in G.S. 116D-22, would include rents, charges, or fees to be derived by the Board of Governors or a constituent institution from any activity, earnings on the investment of an endowment fund, and funds to be received from grants and contracts. Obligated resources would not include tuition payments or appropriations of general revenues. Obligated resources derived from one institution could not be used to finance a bond project located at a different institution.

To the extent the generation of obligated resources is within the control of the Board of Governors, the Board is authorized and required to increase the underlying fees or charges as necessary to generate sufficient revenues to pay the bonds. An individual institution can not increase a fee or charge without approval of the Board of Governors. The Board must set aside a sufficient amount of obligated resources on a regular basis into a sinking fund pledged to pay the principal and interest on the bonds. The act provides that the State pledges and contracts that it will not limit or alter the rights vested in the Board of Governors with respect to the bonds as long as any bonds are outstanding.

Special obligation bonds may be issued only for projects specifically authorized by the General Assembly, as is the current practice for revenue bonds (self-liquidating bonds). Although this act does not give specific legislative approval for special obligation bond projects, S.L. 2000-168 provides for at least one project financed through special obligation bond proceeds.

The amount of special obligation bonds that can be issued is limited by the extent to which the Board of Governors finds that sufficient obligated resources are "reasonably expected" to be available to pay the debt service. In submitting proposed special obligation bond projects to the General Assembly for approval, the Board of Governors must justify the need for each project and must itemize the cost of the project, the estimated operating costs upon completion, and the sources and amounts of obligated resources to be pledged for repayment of the bonds. The Board of Governors may submit a proposed project for approval by the General Assembly only if the project has been approved by the board of trustees of the institution at which the project would be located.

Reports and Oversight

The act imposes reporting requirements to allow the General Assembly to monitor all aspects of the proposed bonds. The State Treasurer is required to report annually, and upon each issuance of university improvement general obligation bonds and community college general

obligation bonds, on debt service requirements for the bonds. The Community Colleges System Office is required to report quarterly to the Joint Legislative Education Oversight Committee on projects funded from community college general obligation bonds, including total project costs, the amount funded by bonds, expenditures to date, and progress to completion. And the Board of Governors is required to report annually to the Joint Legislative Commission on Governmental Operations on the following:

- The university improvement general obligation bonds, including total project costs, amount funded by bonds, expenditures to date, progress to completion, and estimated operating costs and their proposed source of payment.
- The special obligation bonds, including, for each institution, outstanding debt, specific projects, debt service requirements, actual repayments, compliance with all applicable financial requirements, and trends and revenue streams for obligated resources.

The act also creates a Higher Education Bond Oversight Committee, which will consist of ten members appointed as follows: three by the Speaker of the House of Representatives, three by the President Pro Tempore of the Senate, two by the UNC Board of Governors, and two by the State Board of Community Colleges. It has the authority to receive reports and information from the facilities officers at UNC and its institutions, from the State Treasurer and the State Construction Office, from the Community Colleges System facilities officers, and from representatives of individual community colleges. It is required to review this information and make recommendations regarding the issuance of the bonds and the construction of the projects.

The act provides that existing minority business participation goals apply to projects funded with the bond proceeds. It requires annual reports on this issue to the General Assembly from the State Construction Office and the Board of Governors with respect to university improvement bonds and from the Community Colleges System Office with respect to community college bonds.

The act requires the State Treasurer to provide contracting opportunities for historically underutilized businesses in providing professional services in connection with the issuance of the bonds. It directs the State Treasurer to strive to increase the amount of legal, financial, and other professional services acquired by it from historically underutilized businesses, and to report quarterly to the Office for Historically Underutilized Businesses in the Department of Administration

The act directs the Board of Governors to continue to study and monitor any inequities in funding for capital improvements and facilities needs which may still exist on North Carolina's public historically black colleges and universities and the University of North Carolina at Pembroke, beyond the funding of the projects provided for in the act. The Board must report annually to the Joint Legislative Commission on Governmental Operations on any remaining inequities found, including recommendations as to how those inequities should be addressed.

Repairs and Renovations

The act contains two uncodified sections addressing the issue of maintaining the Universities' capital facilities. In the act, the General Assembly finds that the facilities of the universities have been allowed to deteriorate due to inadequate maintenance. Through the act, the General Assembly commits to responsible stewardship of the facilities by requiring monitoring and reporting of the conditions of all facilities and their needs for repair and renovation. The act states the intent of the General Assembly to assure that adequate oversight, funding, and accountability is continually provided with respect to the maintenance of university facilities. The Board of Governors must report annually to Governmental Operations and Education Oversight

on the condition of all university capital facilities, the status of ongoing repair and renovation projects, and needs for additional funding. In addition, the act requires the Board of Governors to study the current repairs and renovation funding formula and make recommendations regarding its adequacy, scope, and methodology.

EXCISE TAX ON TIMBER CONTRACTS

Session Law #	Bill #	Sponsor
S.L. 2000-16	**HB 1545**	**Representative Pope**

AN ACT TO CLARIFY THAT THE EXCISE TAX ON CONVEYANCES APPLIES TO TIMBER DEEDS AND CONTRACTS FOR THE SALE OF STANDING TIMBER.

OVERVIEW: This act clarifies that the State excise tax on instruments conveying an interest in real property applies to timber deeds and contracts for the sale of standing timber. The Revenue Laws Study Committee recommended this legislation to end any confusion resulting from two court decisions regarding the treatment of timber deeds and contracts for the sale of standing timber.

FISCAL IMPACT: No impact.

EFFECTIVE DATE: The act became effective July 1, 2000, and applies to timber deeds and contracts for the sale of standing timber executed on or after that date.

BACKGROUND & ANALYSIS: Historically, timber interests have been treated as an interest in real property, and the State excise tax on conveyances has been applied to deeds conveying timber. With the adoption of the Uniform Commercial Code, the sale of standing timber was deemed to be a sale of goods. Two North Carolina court decisions have addressed timber rights since the adoption of the UCC. The cases have led to disagreement among legal scholars and registers of deeds as to whether contracts for the sale of standing timber and timber deeds constitute a sale of personal property or a sale of real property for purposes of the excise tax on conveyances.

The proponents of timber as real property claim that these court decisions refer to timber as goods under the UCC only when the timber is subject to a contract for sale. The proponents of timber as personal property claim that both contracts and deeds for the sale of timber are governed by the UCC and, therefore, do not convey an interest in real property. This act clarifies that the excise tax on instruments conveying an interest in real property applies to timber deeds and contracts for the sale of standing timber. For purposes of Article 8E, Excise Tax on Conveyances, the timber will be treated as if it were real property. The act remedies any confusion resulting from the court decisions regarding the treatment of timber deeds and contracts for the sale of standing timber.

The excise tax on conveyances applies to conveyances of an interest in real property. The tax is imposed at the rate of $1.00 on each $500.00 or fractional part of the consideration or value of the interest or property conveyed. It is payable to the register of deeds at the time the interest in the property is recorded. One-half of the money generated by the tax stays with the county and the remainder is remitted to the State and credited to the Parks and Recreation Trust Fund and the Natural Heritage Trust Fund.

North Carolina adopted the UCC as Chapter 25 of the General Statutes in 1965. G.S. 25-2-107(2), as amended in 1975, provides that "(a) contract for the sale … of timber to be

cut is a contract for the sale of goods within this article…" Consequently, the excise tax should not be imposed on timber deeds or contracts for the sale of standing timber if they are sales of personal property. However, G.S. 25-2-107(3) recognizes that a contract for the sale of standing timber can be treated as a conveyance of real property: "The provisions of this section are subject to any third-party rights provided by the law relating to realty records, and the contract for sale may be executed and recorded as a document transferring an interest in land and shall then constitute notice to third parties of the buyer's rights under the contract for sale."

There have been two North Carolina cases that have ruled on timber rights since the adoption of the UCC. In *Mills v. New River Wood Corp., 77* N.C. App. *576*, 333 S.E.2d *759* (1985), the Court ruled that contracts for the sale of "timber to be cut" were governed by G.S. 25-2-107(2). In *Mills,* the cause of action was based on a timber deed, which the Court described as evidencing the underlying contract of sale. In a more recent case, the North Carolina Supreme Court concluded that when North Carolina adopted the UCC, it began classifying timber as goods when timber was the subject of a contract for sale. *Fordham v. Eason,* 521 S.E. 2d 701 (1999).

Despite these recent court decisions that argue timber deeds are personal property, most registers of deeds have continued to impose an excise tax on transfers of interests in timber deeds and contracts. This act ends the confusion by expressly providing that the excise tax on instruments conveying an interest in real property applies to timber deeds and contracts for the sale of standing timber.

EXEMPT DISABLED VETERAN VEHICLES

Session Law #	Bill #	Sponsor
S.L. 2000-18	**HB 133**	**Representative Rogers**

AN ACT TO EXEMPT FROM PROPERTY TAX MODIFIED MOTOR VEHICLES OWNED BY DISABLED VETERANS WHO ARE ELIGIBLE FOR FEDERAL SPECIAL EQUIPMENT ALLOWANCES.

OVERVIEW: This act exempts motor vehicles that are (1) owned by veterans with certain service-related disabilities and (2) altered with special equipment to accommodate the service-related disability from property tax.

FISCAL IMPACT: The act will not affect State revenues. It will reduce revenues of local governments by approximately $120,00 per year.

EFFECTIVE DATE: Effective for tax years beginning on or after July 1, 2000.

BACKGROUND & ANALYSIS: Under current law, a property tax exemption is granted to vehicles that the U.S. government gives to veterans on account of disabilities they suffered in World War II, the Korean Conflict, or the Vietnam Era. This act also gives a property tax exemption to vehicles owned by veterans with certain service-related disabilities when the vehicles have been altered to accommodate the disability. Vehicles owned by these veterans and so altered would be eligible for the property tax exemption. To qualify for the exemption, the person must meet the following requirements under federal law:

- Veteran – Be a person who served in active military, naval, or air service, and who was discharged or released under conditions other than dishonorable.

- Service-related disability – Be disabled from an injury incurred or disease contracted in or aggravated by active service. The disability must be loss of one or both hands or feet, permanent loss of use of one or both hands or feet, or permanent impairment of vision of both eyes.
- Adaptive equipment – Have a vehicle that has been adapted for the disability. Adaptive equipment includes, but is not limited to, power steering, power brakes, power window lifts, power seats, and special equipment necessary to assist the veteran into and out of the automobile or other conveyance. The term also includes (1) air-conditioning equipment when the equipment is necessary to the health and safety of the veteran and to the safety of others, regardless of whether the vehicle is to be operated by the veteran or for the veteran by another person, and (2) any modification of the size of the interior space of the vehicle if needed because of the physical condition of the veteran in order for the veteran to enter or operate the vehicle.

The United States Department of Veterans Affairs (VA) offers a one-time payment of up to $8,000 towards the purchase of an automobile to all eligible veterans. In addition, the VA will also pay for adaptive equipment and for the repair, replacement, or reinstallation of adaptive equipment. Veterans who are eligible for these federal benefits will also be entitled to the tax exemption provided by this act.

In order to receive the exemption, the veteran must first file an application with the county assessor. Once an approved exemption is on file, it remains in effect and the vehicle is omitted from the tax rolls. The application need not be renewed each year.

DRY CLEANING SOLVENT CLEANUP AMENDS.

Session Law #	Bill #	Sponsor
S.L. 2000-19	**HB 1326**	**Representative Gibson**

AN ACT TO DESIGNATE THE STATE SALES TAX REVENUE FROM DRY-CLEANING AND LAUNDRY SERVICES TO THE DRY-CLEANING SOLVENT CLEANUP FUND; TO INCREASE THE STATE SALES TAX ON DRY-CLEANING SOLVENTS; TO AMEND THE DRY-CLEANING SOLVENT CLEANUP ACT OF 1997 TO REPEAL THE REQUIREMENT OF FINANCIAL RESPONSIBILITY FOR DRY-CLEANING FACILITIES AND WHOLESALE DRY-CLEANING SOLVENT DISTRIBUTION FACILITIES; TO ALLOW THE ENVIRONMENTAL MANAGEMENT COMMISSION TO ENTER INTO CONTRACTS WITH PRIVATE CONTRACTORS FOR ASSESSMENT AND REMEDIATION ACTIVITIES AT DRY-CLEANING SOLVENT DISTRIBUTION FACULTIES; TO DIRECT THE SECRETARY OF ENVIRONMENT AND NATURAL RESOURCES TO STUDY THE USE OF DRY-CLEANING SOLVENTS IN NORTH CAROLINA, AND TO MAKE OTHER CHANGES IN THE DRY-CLEANING SOLVENT CLEANUP ACT OF 1997.

OVERVIEW: This act earmarks a percentage of the State sales and use taxes collected on dry-cleaning and laundry services to the Dry-Cleaning Solvent Cleanup Fund, increases the privilege and excise taxes on dry-cleaning solvents, and clarifies that the sales tax is treated as part of the sales price for services as well as tangible personal property.

FISCAL IMPACT: Beginning in fiscal year 2003-2004, approximately $9.1 million per year will be transferred from the General Fund to the Dry-Cleaning Solvent Cleanup Fund due to the earmarking of State sales and use taxes collected on dry-cleaning and laundry services. The

increase in the privilege and excise taxes on dry-cleaning solvents will generate an additional $500,000 in revenue each year for the Dry-Cleaning Solvent Cleanup Fund. The provision that clarifies that the sales tax is treated as part of the sales price for services as well as tangible personal property has no effect on State revenues.

EFFECTIVE DATE: The earmarking of sales and use tax proceeds becomes effective April 1, 2003, and expires June 30, 2010. The increase in the privilege and excise taxes becomes effective October 1, 2001, and expires January 1, 2010. The clarifying provision became effective June 26, 2000.

BACKGROUND & ANALYSIS: The Dry-Cleaning Solvent Fund was created by the General Assembly in 1997. The Fund is to be used to reimburse persons who clean up sites polluted by dry-cleaning solvents that have contaminated the water or surface or subsurface soils of the State. The Department of Environment and Natural Resources administers the Fund. Under current law, the major source of revenue for the Fund is a dry-cleaning solvent tax on in-state retailers that sell solvent to dry-cleaning facilities, and on dry-cleaning facilities that purchase solvent outside the State. The solvent tax is a per gallon privilege tax equal to $5.85 per gallon of chorine-based solvents, and 80 cents per gallon of hydrocarbon-based solvents. The tax became effective October 1, 1997 and expires January 1, 2010. The Department of Revenue collects the tax in the same manner as a sales tax.

This act increases the revenues of the Fund in two significant ways. First, under this act, at the end of each quarter, the Department of Revenue will transfer fifteen percent (15%) of the net revenues collected from the sales and use tax on dry-cleaning and laundry services in the previous fiscal year. Under current law, the 4% State sales and use tax is imposed on the gross receipts of the following retailers:

- Persons engaged in the business of operating a dry-cleaning, pressing, or hat-blocking establishment, a laundry, or any similar business.
- Persons engaged in the business of renting clean linen or towels or wearing apparel, or any similar business.
- Persons engaged in the business of soliciting cleaning, pressing, hat blocking, laundering, or linen rental business for any of these businesses.

The following receipts are exempt from the State sales and use tax: receipts derived from services performed for resale by a retailer that pays the tax on the total gross receipts derived from the services; and receipts derived from coin, token, or card-operated washing machines, extractor, and dryers.

Second, this act increases the rate of the privilege tax imposed on the dry-cleaning solvent retailer and the rate of the excise tax imposed on dry-cleaning solvent purchased outside of the State for storage, use, or consumption within the State. The privilege tax and excise tax rate is raised from $5.85 per gallon to $10.00 per gallon for dry-cleaning solvent that is chlorine-based. The privilege tax and excise tax rate is raised from $.80 per gallon to $1.35 per gallon for dry-cleaning solvent that is hydrocarbon based.

HEALTH CARE FACILITY/CCRC TAX EXEMPT

Session Law #	Bill #	Sponsor

S.L. 2000-20	HB 1573	Representative Jarrell

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

OVERVIEW: This act does two things. First, it provides that the current property tax exemption for continuing care retirement centers (CCRCs) will remain in effect for one more year, by extending the exemption's sunset from July 1, 2000, to July 1, 2001. Second, it clarifies the property tax exemption for health care facilities financed with bonds or notes issued by the Medical Care Commission in two ways:

- The amount of the exemption cannot exceed the lesser of the principal amount of the bonds or notes or the assessed value of the facility.
- Only the part of a health care facility financed by bonds or notes issued by the Medical Care Commission is exempt from property tax. When bonds or notes are used to finance an expansion or a renovation of an existing facility, only the new part of the facility or the renovated part of the facility may be exempt from property tax, not the entire facility.

FISCAL IMPACT: The act has no fiscal impact on State revenues. The extension of the sunset of the CCRC property tax exemption has no fiscal impact on local governments. The Medical Care Commission bond clarification will not affect facilities funded under existing bonds. Since Fiscal Research cannot anticipate the amount of bonds to be issued in the future to these facilities, no fiscal estimate is possible.

EFFECTIVE DATE: The extension of the sunset of the CCRC property tax exemption became effective July 1, 2000. The clarification of the property tax exemption for facilities financed with bonds issued by the Medical Care Commission act becomes effective October 1, 2000, and applies to bonds or notes issued on or after that date.

BACKGROUND & ANALYSIS: The Revenue Laws Study Committee recommended two property tax proposals that were combined into this one act:

Extension of the Property Tax Exemption for CCRCs

North Carolina has long exempted from property tax homes for the aged, sick, and infirm if the homes are used exclusively for a charitable purpose and the owner of the property is not organized for profit. (G.S. 105-278.6) In 1983 and 1984, the North Carolina courts ruled that two retirement homes that had sought to claim this property tax exemption did not qualify because the homes were not charitable. In response to the courts' rulings, the General Assembly enacted a property tax exemption in 1987 for certain homes for the "aged, sick, or infirm". To qualify for the exemption, a CCRC did not have to be operated as a charity, but it did have to be owned and operated by a nonprofit organization that was a religious or Masonic organization. [G.S. 105-275(32)]

In 1998, Springmoor, Inc., a nonprofit corporation that manages and operates a self-contained residential community for the elderly, successfully challenged the constitutionality of the 1987 legislation. Springmoor alleged that its center met all the requirements of G.S. 105-275(32), except that it was not affiliated with a religious or Masonic organization as required by a subpart of the statute. The North Carolina Supreme Court agreed that the statute violated the

First Amendment because it was an unconstitutional establishment of religion. Instead of severing the unconstitutional subpart from the statute, which would have given Springmoor exempt status, the Court ruled the entire statute unconstitutional. The Court explained that it was not the General Assembly's intent to provide a blanket exclusion for all nonprofit homes for the elderly.

After the *Springmoor* decision, the General Assembly enacted G.S. 105-278.6A. This statute temporarily revises the property tax exemption for retirement communities that was held unconstitutional in *Springmoor*. The exemption was scheduled to expire July 1, 2000. The Revenue Laws Study Committee appointed a subcommittee consisting of interested parties (including representatives of the CCRCs, the counties, and the tax assessors) to review the tax status of the CCRCs and to seek a compromise. During its six meetings, the subcommittee discussed numerous proposals and looked at other states' laws. Because the subcommittee did not reach a consensus, it recommended extension of the sunset on the property tax exemption for one year, until July 1, 2001, in order to give all interested parties more time to seek a compromise.

Medical Care Commission Bonds

This act clarifies the property tax exemption for health care facilities financed with bonds or notes issued by the Medical Care Commission in two ways:

- The amount of the exemption cannot exceed the lesser of the principal amount of the bonds or notes or the assessed value of the facility.
- Only the part of a health care facility financed by bonds or notes issued by the Medical Care Commission is exempt from property tax. When bonds or notes are used to finance an expansion or a renovation of an existing facility, only the new part of the facility or the renovated part of the facility may be exempt from property tax, not the entire facility.

In 1975, the General Assembly enacted the Health Care Facilities Finance Act to help and encourage the modernization and expansion of the State's health care facilities. Under the Act, the Medical Care Commission may issue bonds or notes to finance the cost of building or improving health care facilities for public or nonprofit agencies. The Medical Care Commission indicates that over the last 20 years, approximately $5 billion in bonds or notes have been issued. Approximately 90% of these bonds or notes have been issued to hospitals for expansion and renovation of hospital facilities and for purchasing hospital equipment.

The Act provides that a health care facility financed through bonds or notes issued by the Medical Care Commission is exempt from property tax until the bonds or notes are retired. At the time the Act was enacted, the Medical Care Commission actually owned most, if not all, of the facilities financed through bond revenues until the bonds or notes were retired. Ownership was given to a public or nonprofit agency after the bonds or notes were retired. Today, the Commission does not generally own the facilities being financed; ownership remains with the public and nonprofit health care facilities requesting the financing. Most of these facilities are exempt from property tax under G.S. 105-278.8. The exemption being amended by this act was included in the law in 1975 because the Medical Care Commission did not fall within the tax exemption for charitable hospital purposes.

LINCOLN COUNTY E&R BOARD

Session Law #	Bill #	Sponsor
S.L. 2000-40	**HB 1656**	**Representative Kiser**

AN ACT TO AUTHORIZE THE APPOINTMENT OF A SPECIAL BOARD OF EQUALIZATION AND REVIEW FOR LINCOLN COUNTY.

OVERVIEW: This act revises Lincoln County's authority to appoint a special board of equalization and review. Most notably, it allows the board to continue meeting after it has adjourned for the purposes of hearing and deciding appeals related to discovered property, classified motor vehicles, audits of property classified at present-use value, and audits of property exempted from or excluded from taxation.

FISCAL IMPACT: None

EFFECTIVE DATE: June 30, 2000

BACKGROUND & ANALYSIS: Under general law (G.S. 105-322), all counties must have a board of equalization and review (E&R board) to review the county's property tax listings and appraisals and to hear taxpayers' appeals. The E&R board is composed of the board of county commissioners unless the board of county commissioners adopts a resolution appointing a special board. This act makes local modifications to G.S. 105-322 for Lincoln County, setting forth specific qualifications for the E&R board and expanding its powers and duties.[3] Specifically, this act makes the following local modifications to G.S. 105-322:

- **Membership**: This act provides that if the Lincoln County board of commissioners chooses to form a special E&R board, they must appoint five members and three alternate members. To be eligible for appointment, the person must have knowledge of or experience in real estate, fee appraisals, banking, farming, or other business management. Members serve two-year terms, and no member may serve more than three consecutive terms. The Lincoln County board of county commissioners will fill vacancies. Under general law, the county board of commissioners can specify the membership, qualifications, and terms of office and the filling of vacancies on the board.
- **Appeals**: Under general law, when a county appoints a special E&R board, it may allow taxpayers to appeal to the board of county commissioners from decisions of the special board. This act deletes that authority for Lincoln County. Thus, if Lincoln County appoints a special E&R board, the special board's decisions are appealable directly to the Property Tax Commission (G.S. 105-290) and from there to the court of appeals (G.S. 105-345).
- **Quorum**: This act specifies that a majority of the members of the special board constitute a quorum for the purpose of transacting business. Decisions are made by a majority of the members present. An alternate member, when sitting as a member, has all of the powers and duties of a regular board member.

[3] Currently, at least 11 other counties have received modifications to G.S. 105-322 to fit their specific needs: Buncombe, Cabarrus, Catawba, Craven, Cumberland, Durham, Henderson, Iredell, Mecklenburg, Rockingham, Stokes, and Union.

- **Clerk**: Under general law, only the assessor can serve as clerk to a special E&R board. This act provides that for Lincoln County either the assessor or a person designated by the assessor will serve as clerk. Under general law, the clerk's duties include being present at all meetings, maintaining accurate minutes of the actions of the boards, and providing the board with information on the listing and valuation of taxable property in the county. This act expands the clerk's duties for Lincoln County to include drafting all written decisions of the special board, and specifies that the chair will review all written decisions drafted by the clerk. Furthermore, the act stipulates that only the chair, or in the chair's absence, the vice chair, can execute the decisions of the special board.

- **Time of Meeting**: The act maintains the general law setting an April or early May starting date for meetings of the E&R board, but changes the deadline for the completion of duties. Under general law, in non-revaluation years, a special E&R board must complete its duties within four weeks, although this deadline may be extended to July 1 if necessary. In revaluation years, a special E&R board must complete its duties by December 1, except to hear taxpayers' appeals filed before its adjournment. The act provides that the Lincoln County E&R board must complete its duties by July 1, except that it may sit year round to hear taxpayer appeals related to discovered property, classified motor vehicles, audits of present-use value property, and audits of exempt or excluded property. Under general law (G.S. 105-325), the board of county commissioners may meet after its special E&R board has adjourned only for limited purposes such as to correct clerical errors, to add discovered property to the lists, and to address facts that should have been, but were not, known before the special board adjourned.

- **Powers and Duties**: The act also expands the duties and powers of the Lincoln County E&R board by adding the following powers and duties:

    1. Duty to Appoint Motor Vehicle Review Subcommittee: The chair of the E&R board must appoint a subcommittee at the first meeting of the calendar year to meet as needed to hear and decide all appeals relating to the appraisal, situs, and taxability of classified motor vehicles. Because motor vehicles are taxed on a staggered, year-round schedule, the subcommittee must be available throughout the year to hear motor vehicle appeals.

    2. Power to Designate Reappraisal Year Panels: In a reappraisal year, the chair of the E&R board may divide the board into separate panels of three members, which may include the alternate board members. A decision of the panel constitutes a decision of the E&R board.

MODIFY BILL LEE ACT

Session Law #	Bill #	Sponsor
S.L. 2000-56	**HB 1560**	**Representative Allen**

AN ACT TO MAKE MODIFICATIONS TO THE WILLIAM S. LEE ACT AND TO RELATED ECONOMIC DEVELOPMENT LAWS.

OVERVIEW: This act modifies the William S. Lee Quality Jobs and Business Expansion Act and related economic development laws by enacting application fee changes, extending credit carryforwards, requiring wage standards for grants, prohibiting funding for defaulting grantees, expanding credits, and making technical corrections. The provisions of the act are listed below:

PROVISION	EFFECTIVE DATE	FISCAL IMPACT
Application Fee Exemptions		
Exempts taxpayers applying for certification for a tax credit in a development zone from the $500 per credit application fee. Clarifies that there is no application fee associated with the application filed with the Department of Commerce concerning the credit for contributions for a development zone project.	1/1/2001 for applications made on or after that date	Insignificant impact
Extend Credit Carryforwards		
Provides an enhanced carryforward of 10 years for a taxpayer who certifies that it will purchase or lease, and place in service within two years, at least $50 million worth of real property, machinery and equipment, or central office or aircraft facility property. The general Bill Lee Act carryforward is five years.	1/1/00	No fiscal impact until fiscal year 2013-2014
Require Wage Standard for Grants		
Requires the following to meet the Bill Lee Act wage standard: • A business seeking a grant from the Industrial Recruitment Competitive Fund. • A local government seeking a loan or grant from the Industrial Development Fund.	7/1/00	N/A
Prohibit Funding for Defaulting Grantee		
Prohibits the Department of Commerce from making a loan or awarding a grant to a person who is currently in default on any loan made by the Department.	7/1/00	N/A
Aircraft Maintenance Facility Credit		
Allows an auxiliary subdivision of an interstate passenger air carrier engaged primarily in aircraft maintenance and	1/1/01	This change is expected to reduce General Fund revenues by $30,000 in fiscal year

PROVISION	EFFECTIVE DATE	FISCAL IMPACT
repair services or aircraft rebuilding to qualify for the Bill Lee Act tax credits.		2002-2003, $60,000 in fiscal year 2003-2004, and $90,000 in fiscal year 2004-2005
Employee Buyout Incentive		
Revises the test for what constitutes an acquisition of a business by an employee buyout. An existing business that is acquired through an employee buyout is able to qualify for the Bill Lee Act credits to the same extent as a new business.	5/1/99	Insignificant impact
Low-Income Housing Credit Changes		
Allows a 75% credit for low-income buildings located in a county that has been designated as having sustained severe or moderate damage from a hurricane or hurricane-related disaster.	1/1/01	Insignificant impact
Clarifies that a building that fails to meet the eligibility requirements for the State low-income housing credit during the five-year installments of the credit forfeits the remaining installments.	1/1/00	Insignificant impact
Modify Credit and Expiration Provisions		
Modifies the jobs tax credit to allow a taxpayer to claim a tax credit for creating a full-time job when it has 5 full-time employees regardless of how many weeks those employees work during the taxable year.	1/1/00	Insignificant impact
Corrects a provision in the tax credit for investing in machinery and equipment that penalizes a taxpayer for replacing recently acquired equipment with new equipment.	1/1/00	N/A
Clarifies that a taxpayer loses any remaining installments on tax credits claimed under the Bill Lee Act if the taxpayer ceases to engage in an eligible business.	1/1/00	N/A
Technical Correction		
Clarifies that an insurance company qualifies for a sales tax refund on certain	5/1/99	N/A

PROVISION	EFFECTIVE DATE	FISCAL IMPACT
purchases if it is operated for the exclusive purpose of providing insurance products to certain nonprofit organizations or to public institutions and their employees.		

Background & Analysis:

History of the Bill Lee Act

The William S. Lee Quality Jobs and Business Expansion Act (hereinafter Bill Lee Act) was enacted in 1996, effective beginning with the 1996 tax year with a 2002 sunset. The Act is a package of State tax incentives and has been modified in each subsequent year. The incentives are primarily in the form of tax credits for investment in machinery and equipment, job creation, worker training, and research/development. For many of the credits the counties are divided into five economic distress tiers based on the unemployment rate, per capita income, and population growth of the county. In general, the lower the tier of a county, the more favorable the incentive.

The Act requires the Department of Commerce to report annually on the credits allowed by the Act. In 1997, the General Assembly added specific issues that the Department of Commerce was required to study and report back on in 1999. Before 1996, North Carolina had made little use of tax incentives to lure businesses to the State. Even without incentives, North Carolina was consistently one of the top states in attracting industry. The array of credits authorized by the Bill Lee Act was viewed as an experiment, to be evaluated in five years to determine whether the incentives were cost effective and actually affected behavior, or merely provided tax reductions to businesses that would have located or expanded in any case. In 1999, the General Assembly expanded existing tax incentives for businesses, added new tax incentives and tax reductions for specific businesses, and made related changes. The General Assembly also extended the 2002 sunset to 2006.

During the 2000 Session, the General Assembly further modified the Bill Lee Act and related economic development laws by enacting application fee changes, extending credit carryforwards, requiring wage standards for grants, prohibiting funding for defaulting grantees, expanding credits, and making technical corrections.

Application Fee Exemptions

To claim a credit under the Bill Lee Act, a taxpayer must provide with the tax return the certification of the Secretary of Commerce that the taxpayer meets all of the eligibility requirements with respect to each credit that the taxpayer claims. The taxpayer must file an application for certification with the Secretary. In 1999, the General Assembly eliminated the $75 application fee for credits claimed in tiers one and two counties. For tiers three, four, and five counties, the application fee was increased to $500 per credit claimed with a cap of $1,500 per applicant. This act extends the fee exemption to apply not only to credits claimed in tiers one and two, but also credits claimed in a development zone. A development zone is an area within the corporate limits of a city with a population over 5,000. The area, composed of one or more contiguous census tracts or census block groups, must have a population of 1,000 or more. Of that population, more than 10% must be below the poverty level or the area must

be adjacent to a tract or group that has more than 20% of its population below the poverty level.

This act also clarifies that there is no fee for an application filed with the Department of Revenue concerning the credit for a development zone project. In 1999, the General Assembly created a new tax credit for taxpayers that contribute cash or property to certain nonprofit agencies to be used for an improvement project in a development zone. An improvement project is a project to construct or improve real property for community development purposes or to acquire real property and convert it for community development purposes. The credit allowed is 25% of the amount contributed by the taxpayer. The total amount of credits that may be allowed in a taxable year is capped at $4 million. Taxpayers are required to apply to the Secretary of Revenue for these credits. If the total amount of credit applied for in a year exceed $4 million, the Secretary will reduce each applicant's credit proportionally.

These changes become effective January 1, 2001, and apply to applications made on or after that date.

Extend Credit Carryforwards

The Bill Lee Act credits may not exceed 50% of the tax against which they are claimed. The limitation applies to the cumulative amount of credit claimed by the taxpayer, including carryforwards. As a general rule, any unused portion of a credit may be carried forward five years. The Bill Lee Act provides two exceptions that allow twenty-year carryforwards. This act creates a third exception that allows a ten-year carryforward, effective for taxable years beginning on or after January 1, 2000. The three exceptions are:

- Any unused portion of a credit with respect to a large investment may be carried forward for 20 years. A large investment is one where an eligible business purchases or leases, and places in service within a two-year period, $150 million worth of one or more of the following: real property, machinery and equipment, or central administrative office property.
- Any unused portion of a credit with respect to the technology commercialization credit may be carried forward for 20 years. The General Assembly created the technology investment credit in 1999 as an alternative to the 7% credit for investing in machinery and equipment. The credit applies only to investments in machinery and equipment used in production based on technology licensed from a research university. The investments must be located in a tier one, two, or three county and must equal at least $10 million during the taxable year and must total at least $100 million over a five-year period.
- This act allows any unused portion of a credit to be carried forward for 10 years if the Secretary of Commerce certifies that the taxpayer will purchase or lease, and place in service in connection with an eligible business within a two-year period, at least $50 million worth of one or more of the following: real property, machinery and equipment, or central office or aircraft property. If the taxpayer fails to make the level of investment certified within the two-year period, the taxpayer forfeits the enhanced carryforward period.

Require Wage Standards for Grants

To be eligible for the credits under the Bill Lee Act, the jobs for which a credit is claimed and the jobs at the location with respect to which a credit is claimed must meet the applicable wage standard. For a tier one county, the jobs must pay an average weekly wage that is equal to the average weekly wage for that county. For other tier counties, the average weekly wage

must equal 110% of the average weekly wage for that county. Effective July 1, 2000, this act requires jobs at the following projects also to meet the Bill Lee Act wage standards:

- A project for which a business seeks a grant from the Industrial Recruitment Competitive Fund. The purpose of this Fund is to provide financial assistance to those businesses or industries deemed by the Governor to be vital to a healthy and growing State economy and that are making significant efforts to establish or expand in the State.
- A project for which a local government seeks a loan or grant from the Industrial Development Fund. The purpose of this Fund is to assist local government units of the most economically distressed counties in creating jobs in certain industries.

Prohibit Funding for Defaulting Grantees

Effective July 1, 2000, the act prohibits the Department of Commerce from making a loan or awarding a grant to any individual, organization, or governmental unit that is currently in default on any loan made by the Department of Commerce.

Aircraft Maintenance Facility Credit

The act expands the list of eligible businesses that qualify for a credit under the Bill Lee Act to include an auxiliary subdivision of an interstate passenger air carrier engaged primarily in aircraft maintenance and repair services or aircraft rebuilding. An interstate passenger air carrier is a person whose primary business is scheduled passenger air transportation. This change is effective for taxable years beginning on or after January 1, 2001. It allows the air carrier to qualify for the central administrative office credit as well as the credit for creating jobs, credit for investing in machinery and equipment, credit for research and development, and credit for worker training. It also allows the air carrier to qualify for the enhanced twenty-year carryforward for large investments.

Employee Buyout Incentive

The act revises the test for what constitutes an acquisition by an employee buyout. Prior to 1998, the acquisition of a business by an employee buyout did not qualify for Bill Lee Act credits. The credits were allowed only for new and expanding businesses. As a general rule, the acquisition of a business, or any other transaction by which an existing business reformulates itself as another business, does not create new eligibility in the succeeding business. In 1998, the General Assembly provided an exception from this general rule for a business that has closed, has filed a federally required notice that closure is imminent, or has been purchased in an employee buyout. In these cases, the business is able to qualify for the credits to the same extent as a new business.

Effective May 1, 1999, the act revises the test for what constitutes an acquisition of a business by an employee buyout. It provides that the term "acquired" means that as part of the initial purchase of a business by employees, the purchase included an agreement for the employees, through the employee stock option transaction or another similar mechanism, to obtain one of the following:

- Ownership of more than 50% of the business.
- Ownership of not less than 40% of the business within seven years if the business has tangible assets with a net book value in excess of $100 million and has a majority of its operations located in an enterprise tier one, two, or three area.

Low-Income Housing Credit Changes

The act expands the applicability of the low-income housing credit and clarifies that the credit is forfeited under certain circumstances. In 1999, the General Assembly enacted a new tax credit for rehabilitating or constructing low-income housing. The credit is equal to a percentage of the amount of the taxpayer's federal credit for low-income housing with respect to eligible North Carolina low-income housing. The credit is 75% for buildings located in tier one or two counties and 25% for buildings located in other tiers. This act provides that the 75% credit is also allowed for buildings located in a county that has been designated as having sustained severe or moderate damage from a hurricane or a hurricane-related disaster, according to the Federal Emergency Management Agency impact map, revised on September 25, 1999. These counties are Bertie, Beaufort, Bladen, Brunswick, Carteret, Columbus, Craven, Dare, Duplin, Edgecombe, Greene, Halifax, Hertford, Jones, Lenoir, Martin, Nash, New Hanover, Northampton, Onslow, Pasquotank, Pender, Pitt, Washington, Wayne, and Wilson Counties. This change is effective for taxable years beginning on or after January 1, 2001, applies to buildings to which federal credits are allocated on or after January 1, 2001, and expires January 1, 2005.

To qualify for the State credit, the test of what constitutes low-income housing for a building located in a tier three, four, or five county is harder to meet than under the federal law. The federal law requires that either (1) at least 20% of the residential units are rent-restricted and occupied by individuals whose income is 50% or less of area median gross income, or (2) at least 40% of the residential units are rent-restricted and occupied by individuals whose income is 60% or less of area gross income. The State law for a tier three or four county requires that at least 40% of its residential units are rent-restricted and occupied by individuals whose income is 50% or less of area median gross income. For a tier five county, the State law requires that at least 40% of its residential units are rent-restricted and are occupied by individuals whose income is 35% or less of area median gross income. If, in one of the five years in which an installment is claimed, the taxpayer no longer qualifies for the federal credit, the taxpayer is no longer eligible for the State credit. This act clarifies that if a building in a tier three, four, or five county no longer meets the more stringent State tax credit requirements, the remaining installments of the credit may not be taken, even though the building may continue to qualify for the federal credit. This clarification is effective for taxable years beginning on or after January 1, 2000.

Modify Credit and Expiration Provisions of the Bill Lee Act.

The act makes three changes to credits in the Bill Lee Act and to the credits' expiration, effective for taxable years beginning on or after January 1, 2000. These changes were recommended by the Revenue Laws Study Committee and do the following:

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

Jobs Tax Credit Change

The Department of Commerce asked the Revenue Laws Study Committee to make this change to eliminate a restriction that has the unintended consequence of preventing a taxpayer from taking a tax credit for jobs created under certain circumstances. Under prior law, a taxpayer that met the eligibility requirement of the Bill Lee Act, had five or more employees for at least 40 weeks of the taxable year, and hired an additional full-time employee to fill a full-time position located in this State could claim a tax credit for creating a new full-time position. The credit for any specific full-time position may be claimed only once and must be taken in installments over four years. This act amends the jobs tax credit by eliminating the 40-week requirement, since it does not serve any apparent purpose.

The 40-week requirement had the unintended effect of denying the job tax credit to certain taxpayers. For example, an employer was not eligible for this credit if it began operations with more than five employees 13 or more weeks into the taxable year. However, a taxpayer could get around this 40-week requirement by signing a letter of commitment with the Department of Commerce to create at least 20 new full-time jobs in a specific area within a two-year period. This taxpayer would be eligible for a credit in the taxable year after at least 20 employees were hired.

The elimination of the 40-week requirement will have a minimal fiscal impact, since most taxpayers have been able to get around the requirement by signing a letter of commitment. The taxpayers who will benefit from this change are those that did not qualify for a letter of commitment and who began operations with between five and twenty employees more than 12 weeks into the taxable year.

Correct Investment Tax Credit

The act corrects a "reverse loophole" in the Bill Lee Act credit for investing in machinery and equipment. Under prior law, if a taxpayer earned a credit for investing in machinery and then, within the seven-year period that installments of the credit are allowed, replaced the machinery with newly acquired machinery, the taxpayer suffered two consequences. The taxpayer lost the remaining installments earned on the original machinery and received no credit for investing in the replacement machinery except to the extent its value exceeded the value of the original machinery. The act corrects this reverse loophole by providing that the remaining installments of the credit for the original machinery may be taken if the value of newly acquired machinery in the same enterprise tier offsets at least 80% of the value of the original machinery taken out of service. As under prior law, a new credit is allowed to the extent the remaining value of the newly acquired machinery creates a net investment increase in excess of the applicable investment threshold, and there is no penalty if the taxpayer replaces the machinery after the end of the seven-year installment period.

Clarify Expiration of Credits

The act clarifies that if a taxpayer that claims a Bill Lee Act credit ceases to engage in the type of business required for qualification of the credit, then the taxpayer loses any remaining installments of the credit (but does not lose accrued carryforwards).

Technical Correction

In 1999, the General Assembly provided a sales tax refund to certain nonprofit insurance companies for State and local taxes they pay on building materials, supplies, fixtures, and equipment that become a part of their real property and on capitalized computer systems hardware and software. To qualify for these refunds, the insurance company must be operated

for the exclusive purposes of providing insurance products to nonprofit charitable organizations and their employees. In addition, the Secretary of Commerce must certify that the insurance company will invest at least $20 million in this State. This act added the underlined language to clarify that to be eligible for this refund, an insurance company must be operated for the exclusive purpose of providing insurance products to organizations exempt from federal income tax and their employees or to public institutions and their employees. This change became effective May 1, 1999, and applies to taxes paid on or after that date.

CHARTER SCHOOL FUEL EXEMPTION

Session Law #	Bill #	Sponsor
S.L. 2000-72	**HB 1302**	**Representative Bonner**

AN ACT TO EXEMPT FROM TAX MOTOR FUEL SOLD TO CHARTER SCHOOLS.

OVERVIEW: This act exempts charter schools from paying the motor fuels tax.

FISCAL IMPACT: This act is expected to reduce Highway Fund revenues by about $24,000 a year and to reduce Highway Trust Fund Revenues by about $8,000 a year.

EFFECTIVE DATE: October 1, 2000.

BACKGROUND & ANALYSIS: This act adds "motor fuel sold to a charter school for use for charter school purposes" to the list of exemptions from the motor fuel excise tax. Thus, charter schools will join the following list to which the motor fuel excise tax does not apply:

- Motor fuel removed in this State for transportation to another state if the supplier collects tax on the motor fuel at the rate of the motor fuel's destination state.
- Motor fuel sold to the federal government for its use.
- Motor fuel sold to the State for its use.
- Motor fuel sold to a local board of education for use in the public school system.
- Diesel that is kerosene and is sold to an airport.

The motor fuel excise tax rate has two components: a flat rate and a variable rate. The flat rate is 17.5¢ per gallon. The variable component may change every six months. It is added to the flat rate. The variable component is equal to the greater of 3.5¢ a gallon or 7% of the weighted average wholesale price of gasoline and No. 2 diesel fuel for the most recent six-month base period. The current motor fuel tax rate is 23.1¢ a gallon. Due to increases in the weighted wholesale price of these motor fuels, the tax increased during each of the last two six-month base periods from a low of 21¢ in late 1999.

One-half cent a gallon of the motor fuel tax revenue is dedicated to the two underground storage tank funds and the water and air quality account. Seventy-five percent (75%) of the remainder of the revenue generated by this tax is allocated to the Highway Fund and the remaining 25% is credited to the Highway Trust Fund.

A charter school is defined in this act as a nonprofit corporation that has a charter under Part 6A of Article 16 of Chapter 115C of the General Statutes to operate a charter school. G.S. 115C-238.29D limits the number of charter schools to 100 schools statewide. Any person, group

of persons, or nonprofit corporation may apply to the State Board of Education to establish a charter school. However, according to this act, a charter school will qualify for the exemption only if it is operated by a nonprofit corporation. To be approved as a charter school, the applicant must meet the statutory requirements of Part 6A of Article 16 of Chapter 115C and the Board must find that the proposed school will meet one or more of the following objectives:

- Improve student learning.
- Increase learning opportunities for all students.
- Encourage the use of different and innovative teaching methods.
- Create new professional opportunities for teachers.
- Provide expanded educational choices for parents and students.

To enable the Department of Revenue to administer the tax exemption and to verify the eligibility of the applicant for the exemption, this act requires the State Board of Education to direct the Department of Public Instruction to notify the Department of Revenue when the State Board terminates, fails to renew, or grants a charter for a charter school.

Charter schools will be able to buy non-tax-paid fuel directly from suppliers. The Department of Revenue will keep a list of exempt charter schools. Fuel suppliers will be able to check that list and then issue an "exempt card" to the school. The fuel supplier can then sell non-tax-paid fuel to the school, either directly or through a contractor. The school would need to have a storage tank or container for the fuel. Additionally, if the school buys fuel on which the tax has been paid, such as from a retail station, it can obtain a refund from the Department of Revenue.

AMEND BILL LEE ACT TIER DESIGNATIONS

Session Law #	Bill #	Sponsor
S.L. 2000-73	**SB 1318**	**Senator Dalton**

AN ACT TO PROVIDE THAT AN ENTERPRISE TIER TWO AREA MAY NOT BE REDESIGNATED AS A HIGHER-NUMBERED TIER AREA UNTIL IT HAS BEEN AN ENTERPRISE TIER TWO AREA FOR TWO CONSECUTIVE YEARS.

OVERVIEW: This act amends the Bill Lee Act by providing that an enterprise tier two area may not be redesignated as a higher numbered tier area until it has been an enterprise tier two area for at least two consecutive years. In 1997 (S.L. 1997-277), the General Assembly amended the Bill Lee Act to guarantee that a county that obtained a tier one status could not lose that status for two years. The act extends this guarantee to a county designated as a tier two area.

FISCAL IMPACT: The act is expected to reduce General Fund revenues by $111,000 in fiscal year 2001-2002, $233,000 in fiscal year 2002-2003, $344,500 in fiscal year 2003-2004, and $456,000 in fiscal year 2004-2005. The act has no impact on fiscal year 2000-2001 because the credits are taken in the year after the investment and job creation activity take place.

EFFECTIVE DATE: Retroactive to tier designations for the 2000 and later calendar years.

BACKGROUND & ANALYSIS: Under the Bill Lee Act, all counties are divided into five enterprise tiers, ranked by economic distress as measured by a formula that combines unemployment, per capita income, and population growth. Those counties in lower-numbered tiers receive more favorable incentives than those in higher tiers. For example, enterprise tier one and two counties are the counties considered most in need of economic development based on high unemployment, low per capita income, and low population growth.

In 1997, the General Assembly amended the Bill Lee Act to guarantee that a county that obtained a tier one status could not lose that status for two years regardless of what the annual rankings would otherwise require. This act extends this guarantee to a county designated as a tier two area, so that a tier two area may not be redesignated as a higher numbered tier area until it has been a tier two area for two consecutive years.

During the 1999 Session, the Bill Lee Act was amended to provide the following three incentives for development in enterprise tier one and two counties:

- Extended the Bill Lee Act credits to electronic mail order houses that create at least 250 jobs in tiers one and two.
- Extended the Bill Lee Act credits to customer service centers in tiers one and two.
- Allowed an annual refund of 6% sales taxes paid on capitalized machinery and equipment sold to businesses eligible for Bill Lee Act credits and located in tiers one and two.

In 1999, the General Assembly also allowed certain counties to qualify for a lower enterprise tier designation, effective January 1, 2000. The rules for assigning enterprise tier designations were changed to provide that the tier number that would otherwise be assigned by the formula is reduced by one for counties that have a population of less than 50,000 and also have more than 18% of their residents below the federal poverty level. Under this change, Alleghany, Ashe, Beaufort, Cherokee, Perquimans, Scotland, Vance, and Yancey Counties moved from tier two to tier one. Bladen, Hoke, Jones, Madison, Pamlico, and Pasquotank Counties moved from tier three to tier two. The 1999 change also provided that a county that has a population of less than 25,000 cannot be designated higher than tier three. Finally, the 1999 change provided that a county is designated as tier one if it has a population of less than 10,000 and also has more than 16% of its residents below the federal poverty level. Under this change, Camden, Clay, and Jones qualified as tier one counties.

EXTEND CABARRUS E&R BOARD

Session Law #	Bill #	Sponsor
S.L. 2000-92	**SB 1364**	**Senator Hartsell**

AN ACT TO AUTHORIZE THE CABARRUS BOARD OF EQUALIZATION AND REVIEW TO MEET AFTER ITS FORMAL ADJOURNMENT.

OVERVIEW: The act authorizes the Cabarrus County Board of Equalization and Review to meet after its regular adjournment, in order to hear appeals relating to discovered property, motor vehicles, and audits of property taxed at preferential rates.

FISCAL IMPACT: No fiscal impact.

EFFECTIVE DATE: July 7, 2000.

BACKGROUND & ANALYSIS: This act adds Cabarrus County to Section 2 of S.L. 1999-353, which originally applied only to Stokes County. The effect of adding Cabarrus County is to authorize the Cabarrus County Board of Equalization and Review to continue meeting after it has completed its regular duties for the year. Under general law, a special board of equalization and review has the duty to examine and review the tax lists for the current year and to hear any timely request of a taxpayer with respect to the listing or appraisal of property. Under general law, in non-revaluation years, a special E&R board must complete its duties within four weeks, although this deadline may be extended to July 1 if necessary. In revaluation years, a special E&R board must complete its duties by December 1, except to hear taxpayers' appeals filed before its adjournment. This act provides an exception for Cabarrus County, allowing its E&R board to continue to meet after completing its regular duties in order to carry out the following duties:

- To hear and decide appeals relating to discovered property.
- To hear and decide appeals relating to the appraisal, situs, and taxability of classified motor vehicles.
- To hear and decide appeals relating to audits of property classified at present-use value and relating to audits of property exempted or excluded from taxation.

2000 FEE BILL

Session Law #	Bill #	Sponsor
S.L. 2000-109	**HB 1854**	**Representative Miller**

AN ACT TO SET THE PUBLIC UTILITY REGULATORY FEES AND THE INSURANCE REGULATORY CHARGE, TO INCREASE COURT COSTS, TO INCREASE JAIL FEES FOR PERSONS PAYING JAIL FEES PURSUANT TO PROBATIONARY SENTENCES, TO INCREASE THE FEE IMPOSED FOR EMERGENCY PLANNING, TO AUTHORIZE CERTAIN CHANGES IN PERMITS FOR OVERSIZE LOADS AND ESTABLISH PENALTIES FOR PERMIT VIOLATIONS, TO AUTHORIZE AGENCIES TO PROVIDE ACCESS TO SERVICES THROUGH ELECTRONIC AND DIGITAL TRANSACTIONS AND TO IMPOSE A FEE FOR THOSE TRANSACTIONS, AND TO REPEAL THE SUNSET OF THE WHITE GOODS TAX AND DIRECT THE DEPARTMENT OF ENVIRONMENT AND NATURAL RESOURCES TO STUDY ISSUES RELATED TO THE SCRAP TIRE DISPOSAL TAX AND THE WHITE GOODS DISPOSAL TAX.

OVERVIEW: This act makes four tax law changes and five fee law changes; only the tax law changes are summarized here. The tax law changes are:

- Set the tax rates for the public utility regulatory fee for the 2000-2001 tax year.
- Set the tax rate for the North Carolina Electric Membership Corporation regulatory fee for the 2000-2001 fiscal year.
- Set the tax rate for the insurance regulatory charge for the 2000 calendar year.
- Repeal the July 2001 sunset on the White Goods tax.

FISCAL IMPACT:

- Public Utility Regulatory Fee: This fee is expected to generate $9.06 million.
- NC Electric M'ship Corp: This fee is expected to generate $200,000.
- Insurance Regulatory Charge: This fee is expected to generate $25.65 million.
- White Goods Sunset Repeal: This tax generates approximately $4 million a year, which is distributed as follows:
    - The Solid Waste Management Fund receives 8% of the tax.
    - The White Goods Management Account receives 20%.
    - The counties receive the remaining 72%.

EFFECTIVE DATE:

- Public Utility Regulatory Fee: 2000-2001 tax year
- NC Electric M'ship Corp Fee: 2000-2001 tax year
- Insurance Regulatory Charge: 2000 calendar year
- White Goods Sunset Repeal: July 13, 2000

BACKGROUND & ANALYSIS:

Public Utility Regulatory Fee

The act sets the general rate for the public utility regulatory fee at 0.09% for the 2000-2001 fiscal year. This is the same rate that was in effect for both the 1997-1998 and 1998-1999 fiscal years, and is expected to generate $9.06 million. The utility regulatory fee is a tax that was first imposed in 1989. The proceeds of the fee are credited to the Utilities Commission and Public Staff Fund and used to defray the State's cost in regulating public utilities. The regulatory fee is imposed on all utilities that are subject to regulation by the North Carolina Utilities Commission. The fee is a percentage of the utility's North Carolina jurisdictional revenues. In general, jurisdictional revenue is revenue derived from providing utility service in North Carolina.

In addition to funding the State's cost in regulating public utilities, the money in the Utilities Commission and Public Staff Fund is currently used to finance the work of the Study Commission on the Future of Electric Service in North Carolina. The General Assembly established the Commission in 1997 to examine the cost, adequacy, availability, and pricing of electric rates and service in North Carolina to determine whether legislation is necessary to assure an adequate and reliable source of electricity and economical, fair, and equitable rates for all consumers of electricity in North Carolina.

North Carolina Electric Membership Corporation Fee

The act sets at $200,000 the annual public utility regulatory fee imposed on electric membership corporations whose principal purpose is to furnish or cause to be furnished bulk electric supplies at wholesale, as provided in G.S. 117-16, effective for the 2000-2001 fiscal year. The North Carolina Electric Membership Corporation is the only electric membership corporation that fits this description. The proceeds of the fee will be credited to the Utilities Commission and Public Staff Fund and used to defray the State's cost in regulating electric membership corporations.

The 1999 General Assembly enacted S.L. 1999-180, which authorized electric membership corporations to form subsidiary corporations that may provide energy services and products, telecommunications services and products, and water and wastewater collection and treatment. The subsidiaries must fully compensate the electric membership corporation for its use of the corporation's personnel, services, equipment, and property. The Utilities Commission is charged with regulating this aspect of the subsidiary's business and, to pay for this regulation, S.L. 1999-180 levied a flat-rate regulatory fee to be paid annually by the North Carolina Electric Membership Corporation. The General Assembly must establish the fee amount each year. The North Carolina Electric Membership Corporation is the only electric membership corporation whose principal purpose is to furnish or cause to be furnished bulk electric supplies at wholesale, as provided in G.S. 117-16. It is a "generation and supply cooperative" owned by its members. Its members are all but one of the existing North Carolina electric membership corporations, which are "distribution cooperatives." Thus, the fee imposed on the North Carolina Electric Membership Corporation will be passed on to its member electric membership corporations.

Insurance Regulatory Charge

The act sets the insurance regulatory charge at 7% for the 2000 calendar year, the same rate used in the 1999 calendar year. The charge is expected to generate $25.65 million for the 2000-2001 fiscal year. The insurance regulatory charge is a tax that was enacted in 1991 to defray the State's cost of regulating the insurance industry. The charge is a percentage of each insurance company's premiums tax liability. The insurance regulatory charge is imposed on insurance companies that pay the gross premiums tax and, beginning in 2000, on health maintenance organizations and medical service corporations. For health maintenance organizations and medical service corporations, the fee is levied on each company's hypothetical gross premiums tax liability determined at the 1.9% gross premiums tax rate applied to its premiums base. The hypothetical calculation is necessary because medical service corporations pay premiums tax at a rate of 0.5% rather than 1.9% and because health maintenance organizations do not pay premiums tax.

Prior to 2000, the insurance regulatory charge was imposed only on insurance companies that paid the gross premiums tax. Medical service corporations were exempt, and health maintenance organizations did not pay the regulatory charge because they do not pay a gross premiums tax. Prior to 1995, these entities contributed to the Department of Insurance Fund through insurance audit and examination fees. However, in 1995, the General Assembly eliminated the insurance audit and examination fees for insurance companies, health maintenance organizations, medical corporations, and guaranty associations. The costs of the audits are now paid for by the insurance regulatory charge as part of the costs of regulating the insurance industry.

White Goods Sunset Repeal

This act repeals the sunset on the white goods tax. Under prior law, the white goods tax was scheduled to sunset July 1, 2001. The Department of Environment and Natural Resources reports annually to the Environmental Review Commission on the management of white goods. This act directs the Department to study the scrap tire disposal tax as well as the white goods disposal tax, and evaluate whether the amounts of these taxes should be altered or whether the distribution of the proceeds of the taxes should be reapportioned. The Department must make a report on this study to the Environmental Review Commission by October 1, 2000.

The white goods tax was imposed effective January 1, 1994. The purpose of the tax is to provide a source of revenue for the proper disposal of discarded white goods. A white good

is a domestic or commercial large appliance, such as a refrigerator, a water heater, an air conditioner unit, or a dishwasher. The tax is a flat rate charged on every new white good purchased in this State or brought into this State for storage or use. The tax rate is $3.00 per white good. The tax generates approximately $4 million each year.

Proceeds from the white goods tax are distributed as follows: 8% to the Solid Waste Management Trust Fund, 20% to the White Goods Management Account, and 72% to counties. Counties may use the white goods tax proceeds distributed to them only for the management of discarded white goods, which may include capital improvements for infrastructure to manage discarded white goods, operating costs associated with managing discarded white goods, and cleanup of white goods at illegal disposal sites.

Counties are limited in the amount of surplus white goods tax proceeds they can accumulate. Counties receive their distributions of white goods tax proceeds on a quarterly basis. If at the end of a fiscal year, the county has a surplus of white goods tax proceeds that equals or exceeds 25% of the amount it was eligible to receive for the fiscal year, it may not receive additional distributions until its surplus falls below that level. The amount that would have been distributed to a county will instead be credited to the White Goods Management Account.[4]

Counties must include in their annual financial information report to the Local Government Commission information about their management of white goods and their receipt and expenditure of white goods tax proceeds and related revenues. The annual financial information report must be certified by the county finance officer based on an independent audit by a certified public accountant.

TAX ENFORCEMENT

Session Law #	Bill #	Sponsor
S.L. 2000-119	**HB 1551**	**Representative Miller**

AN ACT TO MODIFY THE AUTHORITY OF DEPARTMENT OF REVENUE LAW ENFORCEMENT AGENTS, TO ALLOW THE SECRETARY OF REVENUE TO ADMINISTER THE OATH OF OFFICE TO DEPARTMENT OF REVENUE LAW ENFORCEMENT AGENTS, TO PROVIDE A CIVIL PENALTY FOR FILING A FRIVOLOUS INCOME TAX RETURN, AND TO CHANGE THE PROCEDURES FOR LAW ENFORCEMENT REPORTING ON NON-TAX-PAID UNAUTHORIZED SUBSTANCES.

OVERVIEW: This act makes the following changes to the law to facilitate enforcement of the tax laws:

- It expands the offenses revenue law enforcement officers may enforce to include misdemeanor offenses as well as felony offenses. This part of the act became effective July 14, 2000.
- It authorizes the Secretary of Revenue to administer the oath of office to revenue law enforcement officers. This part of the act became effective July 14, 2000.

[4] Funds in the White Goods Management Account are available for grants to assist local governments in managing white goods. Special legislation in 1999 diverted some of the funds to address specific hazardous waste sites.

- It creates a civil penalty for filing a frivolous income tax return. A frivolous return is one that meets both of the following conditions: (1) it does not include information on which the substantial correctness of the return may be judged or contains information that indicates that the return is substantially incorrect. (2) It evidences an intention to delay, impede, or negate the revenue laws of this State or purports to adopt a position that is lacking in seriousness. The penalty for filing a frivolous return is up to $500. This part of the act becomes effective October 1, 2000, and applies to returns filed on or after that date.
- It streamlines the procedures State and local law enforcement agencies must use to report arrests made for the failure to pay tax on unauthorized substances by allowing them to give the information directly to the Department of Revenue. This part of the act becomes effective December 1, 2000, and applies to arrests or seizures occurring on or after that date.

FISCAL IMPACT: The creation of a civil penalty for filing a frivolous income tax return could produce $300,000 to $1 million in revenue each year for the General Fund.

EFFECTIVE DATE: See the Overview above.

BACKGROUND & ANALYSIS: The Revenue Laws Study Committee recommended this act to the General Assembly, at the recommendation of the Department of Revenue. The act makes several changes to the law to facilitate the enforcement of the tax laws.

Authority of Law Enforcement Agents

The act expanded the offenses revenue law enforcement officers may enforce to include the following misdemeanor offenses:

- Willful failure to collect, withhold, or pay over tax. G.S. 105-236(8).
- Willful failure to file a return, supply information, or pay tax. G.S. 105-236(9).
- Highway use of dyed diesel or other non-tax-paid fuel. G.S. 105-449.117.
- Miscellaneous fuel tax misdemeanors. G.S. 105-449.120.
- Sale of certain packages of cigarettes. G.S. 14-401.18.

Revenue law enforcement officers already have the authority to enforce felony tax violations under G.S. 105-236 and to enforce numerous other offenses under State law when they involve a State tax. The act rewrites G.S. 105-236.1(a) by listing the offenses a revenue law enforcement officer may enforce.

Secretary to Administer Oath of Office

The act authorizes the Secretary of Revenue to administer the oath of office to revenue law enforcement officers. The Secretary is not one of the individuals who have general authorization under G.S. 11-7.1 to administer oaths. The Secretary does, however, have authority under G.S. 105-261 to administer an oath to a person with respect to a tax return or report. The act puts the qualifications for becoming a revenue law enforcement officer, including the oath of office, in a separate subsection.

Civil Penalty for Filing a Frivolous Income Tax Return

The act creates a civil penalty for filing a frivolous income tax return. In order for a return to be frivolous, it must meet both of the following conditions:

- The return does not include information on which the substantial correctness of the return may be judged or it contains information that positively indicates the return is incorrect.
- The return evidences an intention to delay or impede the revenue laws of this State or purports to adopt a position that is lacking in seriousness.

The penalty for filing a frivolous return could be up to $500. As with other penalties assessed under Subchapter I of Chapter 105, this penalty would be assessed as an additional tax. This penalty is similar to a penalty imposed on the federal level under section 6702 of the Internal Revenue Code.

The Criminal Investigations Division of the Department of Revenue requested this change in the law. In its work, the Division has investigated cases in which a taxpayer will knowingly file an incorrect return in order to inflate deductions and thus increase the amount of the taxpayer's refund. For example, a taxpayer may claim extra dependents or exaggerate the amount of charitable contributions. The current penalties do not provide a proper remedy because they are based upon failure to pay the amount of tax due. In most of these cases, there is no amount of tax due because the taxpayer is already due a refund. The offense is that the taxpayer is claiming a greater refund than the taxpayer is entitled to receive.

Streamline the Procedures for Reporting on Non-Tax-Paid Unauthorized Substances

The act relieves the SBI of the burden of reporting drug-related offenses to the Department of Revenue. Under current law, State and local law enforcement agencies have to report to the SBI within 48 hours the arrest of any individual in possession of certain threshold amounts of drugs that do not bear unauthorized substances tax stamps. The SBI must then notify the Department of Revenue on a daily basis of the reports it receives. The SBI does not need this information and requested that it be relieved of this responsibility. Effective December 1, 2000, State and law enforcement agencies will report these arrests directly to the Department of Revenue, as opposed to the SBI. The act makes the following conforming changes: It moves the reporting requirement from Chapter 114 to Article 2D of Chapter 105; it repeals the requirement that the SBI notify the Department on the reports it receives.

STREAMLINED SALES TAX SYSTEM

Session Law #	Bill #	Sponsor
S.L. 2000-120	**HB 1624**	**Representative Miller**

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

OVERVIEW: *This act is a recommendation of the Revenue Laws Study Committee. It seeks to improve the State's tax collections in several different ways:*

- It simplifies and streamlines the sales and use tax collection system for remote and in-state retailers.
- It provides that a remote seller who does not agree to collect the State's use tax may not use the State's courts to collect debts owed to it by a purchaser of its product in this State.

- It allows the Department of Revenue to exchange information concerning a taxpayer's social security number with the Division of Motor Vehicles when it is necessary to identify a taxpayer.
- It provides the Department of Revenue with the resources to continue its collection of delinquent tax debts owed by nonresidents and foreign entities for the remainder of this biennium.
- It allows the Department of Revenue to retain necessary funds from revenues it collects from its nonresident delinquent tax debt contracts to obtain assistance in developing a performance-based contract for an automated collection system. The General Assembly asked the Department and the State Controller to study how to collect taxes more efficiently. The centralization and automation of the Department's delinquent tax debts are the primary recommendations of this study, conducted by PricewaterhouseCoopers.
- It provides that, effective January 1, 2001, the penalty for misusing an exemption certificate applies not only to a certificate of resale, but also to a direct pay certificate and a farmer's certificate.
- It repeals the requirement that a taxpayer report use tax on the income tax return.

FISCAL IMPACT: No fiscal estimate is possible because the legislation is only the first step in establishing a new remote sales and use tax collection system. However, once this remote sales and use tax collection system is completed, the fiscal impact could be significant. A recent study by the University of Tennessee estimates that by 2003 the incremental State and local revenue loss on e-commerce transactions will be $238 million for North Carolina. If the current revenue losses on catalog sales and e-commerce transactions are included, the total amount could be over $400 million.

It is estimated that the implementation of an automated case management tool would increase delinquent tax collections by $11 million to $30 million annually. Additionally, contracting with collection agencies for out-of-state debts and for long-term delinquent accounts would yield an initial $20 million in additional revenues and an increase in recurring revenues of up to $23 million per year.

EFFECTIVE DATE: The provision dealing with the sales tax exemption certificate (Section 7) becomes effective January 1, 2001. The provisions dealing with the repeal of the use tax reporting requirement (Sections 10 and 11) becomes effective for taxable years beginning on or after January 1, 2003. The remainder of the act became effective July 14, 2000.

BACKGROUND & ANALYSIS:

Streamlined Sales Tax Collection System

This act enables North Carolina to become one of four states to participate in the streamlined sales tax collection system pilot project. The National Governors' Association recommended the streamlined sales tax collection system. The recommendation addresses the difficulty states have collecting sales and use taxes on purchases from remote retailers. The recommendation provides a simplified collection process that would allow participating retailers to use a computer software program to be able to calculate the amount of tax due to the State on a purchase based upon the customer's ship-to address. The administration of the program would be the responsibility of a person certified by the State to collect its taxes, not the retailer.

To begin this method of collection, the State must certify a person to act as its tax collector. It is anticipated that the identity of the "certified sales tax collector" will vary depending upon the type of retailer involved. Certain large retailers may choose to act as their own collector.

To be certified as a sales tax collector, this act would require the Secretary of Revenue to find that the person meets all of the following conditions:

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

The State would assume the responsibility for the costs of the system by contracting with the collector to reimburse the collector for the costs of operating the system and for the costs of integrating the system with those of participating retailers. The amount a collector charges under a contract is considered a cost of collecting the tax and is payable from the amount collected. The payments to the collector will be made on a per transaction basis based on negotiated rates. The per-transaction fee could be in the form of a flat per transaction rate, a percentage rate, or a combination of the two types of rates.

Participation in the program by retailers is voluntary. To participate in the program, a retailer must agree to let the certified sales tax collector integrate the certified software with the retailer's system so that the tax due on a sale can be determined at the time of the sale. The information on the amount of tax due will be available to a customer before completion of a transaction. Once the customer approves the purchase, the retailer will send the transaction through the payment processing system and the amount paid to the retailer will be the full amount of the purchase plus tax. A participating retailer will be required to enter into a standing debit authorization agreement with the collector that will enable the collector to debit the retailer's account on an agreed upon schedule for the amount of tax owed all participating states according to transactions processed by the collector. The collector will be liable for remitting the appropriate tax to the participating states. In the absence of fraud, the participating retailer will not be subject to audits by the states on the transactions it processes using the collector's software program. A contract with a collector will not be a factor in considering whether a person has nexus with a state for payment of a tax.

The act also makes the following statutory changes to meet the uniformity features needed to successfully implement the streamlined sales tax collection system:

- It makes the exemption process easier to administer by eliminating the "good faith" requirement when accepting an exemption certificate number from a purchaser on a sale made over the Internet or by other remote means. (Section 6) It codifies a long-standing practice of the Department of Revenue to issue "direct pay certificates" to a person who is unsure how property the person purchases should be taxed at the time the property is purchased. (Section 1) And it provides that, effective January 1, 2001, the penalty for misusing an exemption certificate applies not only to a certificate of resale, but also to a direct pay certificate and a farmer's certificate. (Sections 7 and 18)
- It establishes a uniform sourcing rule that calculates the amount of tax due on a sale based on its "ship-to address". (Section 2) To accomplish this sourcing rule, the bill expands the current sales tax exemption for printed materials that are shipped out-of-state and not subsequently used by the purchaser to include all tangible personal property. (Section 5)
- It provides that the customer of a retailer who participates in the program may not elect to pay the tax directly to the Secretary rather than to the seller. (Section 4)
- It provides that local government sales and use tax rate changes may only be made twice a year and the local government must give the State at least 90 days notice of any tax rate change. (Sections 12 and 13)

Use of NC Courts by Out-of-State Retailers

Under current law, a loan made by a person who fails to pay or comply with the State privilege tax statute, G.S. 105-88, may not be collected through the State's courts. This act extends this exclusion to include debts owed to a retailer who is required by G.S. 105-164.8(b) to collect use tax for the State but refuses to do so if the retailer reported gross sales of at least $5,000,000 on its most recent federal income tax return. (Sections 3 and 9) The exclusion would also apply to any person to whom the debt is assigned. The exclusion would only apply to debts owed on tangible personal property purchased from the retailer. A retailer is required to collect use tax for the State under G.S. 105-164.8(b) if the retailer maintains retail offices in the State, has representatives in the State who solicit business, or purposefully and systematically exploits the market in this State by any media-assisted means such as direct mail advertising, distribution of catalogs, computer-assisted shopping, television, radio, etc.

DMV Disclose Social Security Number to DOR:

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

This act rewrites the drivers license statute pertaining to social security numbers to allow the Division to disclose a social security number to the Department for the purpose of verifying taxpayer identification. (Section 14) It also provides that the Division of Motor Vehicles may not use an applicant's social security number as the identifying number for the license holder. (Section 15) This clarification resolves a conflict between two subsections in G.S. 20-7: subsection (b1) provides that an applicant's social security number may not be printed on the license, while subsection (n) says that the license holder's social security number may be the license holder's identifying number.

Contract for Collection of Delinquent Tax Debts

Last session, the General Assembly allowed the Department of Revenue to contract for the collection of delinquent tax debts owed by nonresidents and foreign entities. A delinquent tax debt is the amount of tax due as stated in a final notice of assessment issued to the taxpayer when the taxpayer no longer has the right to contest the debt. The legislation stated that "[T]he Secretary of Revenue shall contract during the 1999-2001 fiscal biennium for the collection of delinquent tax debts…" However, the legislation provided a funding mechanism for only the first year of the biennium. This act provides funding for the second year of the biennium. It allows the Secretary to retain the costs of the contracts from the amounts collected under the contracts. (Section 16)

The Department is currently involved in a pilot effort to contract for the collection of out-of-state accounts receivable in conjunction with the Office of the State Controller. On March 16, 2000, the Department sent 1,016 accounts with a value of $927,170.46 to the Office of the State Controller for referral to a collection agency. Within the first 30 days, the Department realized a 2.5% return.

Implement Recommendation of PricewaterhouseCoopers to Centralize and Automate Debt Collection System

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

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

The Department would like to implement the recommendations of this study. To centralize its collection process, the Department would like to enter into a performance-based contract where

the person who provides the automated system would be paid from the proceeds of the system based upon some variable that pertains to how well the system works. To enable the Secretary of Revenue to obtain assistance in developing a request for proposal for the performance-based contract, this act allows the Secretary to draw the amount needed from the revenue collected pursuant to the contracts for the collection of delinquent tax debts owed by nonresidents and foreign entities. (Section 17)

CONFORM WITH FEDERAL LAW

Session Law #	Bill #	Sponsor
S.L. 2000-126	**HB 1559**	**Representative Luebke**

AN ACT TO UPDATE THE REFERENCE TO THE INTERNAL REVENUE CODE USED IN DEFINING AND DETERMINING CERTAIN STATE TAX PROVISIONS, TO CONFORM TO FEDERAL LAW REGARDING PENSION TAX WITHHOLDING AND DEADLINES FOR PAYMENTS OF CERTAIN ESTIMATED INCOME TAXES, TO CLARIFY THE SALES FACTOR FOR DETERMINATION OF STATE CORPORATE INCOME AND FRANCHISE TAX, AND TO ENABLE THE COLLECTION OF TAX DEBT OWED TO NORTH CAROLINA THROUGH THE FEDERAL TREASURY OFFSET PROGRAM.

OVERVIEW: This act was a recommendation of the Revenue Laws Study Committee and makes the following changes relating to tax law:

- **Update IRC Reference.** It rewrites the definition of the Internal Revenue Code used in State tax statutes to change the reference date from June 1, 1999, to January 1, 2000. This change became effective for taxable years beginning on or after January 1, 2000.
- **Conform Pension Tax Withholding.** It requires withholding of State income taxes on an eligible rollover distribution to the extent permitted under federal law. This change becomes effective January 1, 2001.
- **Conform Estimated Tax Deadline for farmers and fishers.** It returns the withholding law for farmers and fishers to conformity with federal law, correcting an inadvertent change made in 1985. This change became effective July 14, 2000.
- **Clarify Sales Factor.** It amends the definition of "sales" for purposes of the apportionment formula to clarify that the receipts of a multi-state corporation should include only the net gain realized from the sale or maturity of securities, not the rolled over capital or return of principal and not receipts otherwise exempt from tax. This change became effective July 14, 2000.
- **Participate in Treasury Offset Program.** It enables the Department of Revenue to collect delinquent tax debts owed to the State through the United States Department of the Treasury Offset Program by providing for the imposition of a collection assistance fee. This change became effective July 14, 2000.[5]

FISCAL IMPACT: The Code Update is expected to reduce General Fund revenues by $2,030,000 in fiscal year 2000-2001, and $4,350,000 in fiscal year 2001-2002. The Code

[5] This change was not part of the recommendation of the Revenue Laws Study Committee but was later recommended by the Department of Revenue.

Update is expected to increase General Fund revenues by $650,000 in fiscal year 2002-2003, $850,000 in fiscal year 2003-2004, and $600,000 in fiscal year 2004-2005. Conforming the tax deadline and the pension tax withholding, and clarifying the sales factor for multi-state corporations have no fiscal impact. Participating in the Treasury Offset Program has a potential revenue gain, but no estimate is available.

EFFECTIVE DATE: *See Overview section.*

BACKGROUND & ANALYSIS:

Update Code Reference

Updating the Internal Revenue Code reference makes recent amendments to the Code applicable to the State to the extent that State tax law previously tracked federal law. Since the General Assembly updated the State's reference to the Internal Revenue Code to June 1, 1999, Congress enacted Public Law 106-170, the Tax Relief Extension Act of 1999. That Act extends several expired and expiring tax provisions, some of which affect federal taxable income. Since the computation of State taxable income begins with federal taxable income, any changes to federal taxable income affect State taxable income.

This act rewrites the definition of the Code to change the reference date from June 1, 1999, to January 1, 2000. The act further provides that the federal tax law changes that could increase an individual's or a corporation's State taxable income for the 1999 tax year will not become effective for the 1999 tax year but will instead apply only to taxable years beginning on or after January 1, 2000. This provision is necessary because Article 1, Section 16, of the North Carolina Constitution prohibits the legislature from passing a law that will retroactively increase the tax liability of any taxpayer. There are a few changes in Public Law 106-170 that could increase taxable income for the 1999 tax year. Because the act could not be ratified until after the 2000 Session of the 1999 General Assembly convened, these changes were given a delayed effective date.

The following is a summary of the provisions of the Tax Relief Extension Act of 1999 that may affect State taxable income. These changes apply to taxable years beginning on or after January 1, 2000.

- Delays the sunset of the exclusion from gross income of up to $5,250 annually for employer-provided educational assistance for undergraduate courses. The exclusion would have expired with respect to courses beginning on or after June 1, 2000. Public Law 106-170 extends the exclusion with respect to courses beginning before January 1, 2002.

- Clarifies that no charitable contribution deduction is allowed for a transfer to or for the benefit of a charitable organization if, in connection with the transfer, the organization directly or indirectly pays any premium on any personal benefit contract with respect to the transferor. A personal benefit contract is a life insurance, annuity, or endowment contract. The clarification of this provision does not infer that a charitable split-dollar insurance arrangement was allowed under prior law. It does not apply to a person that benefits exclusively under a bona fide charitable gift annuity within the meaning of the Code.

- Delays the sunset of the work opportunity tax credit and the welfare-to-work tax credit. These credits would have expired for wages paid or incurred to a qualified individual who began work for an employer before July 1, 1999. Public Law 106-170 extends these credits for wages paid to qualified individuals who began work for the employer

on or after July 1, 1999, and before January 1, 2000. To the extent an employer claims the federal credit, the employer must reduce its federal deduction for wages by the amount of the credit. Since North Carolina does not have comparable credits, it allows a taxpayer who claims the federal credits to claim a deduction from federal taxable income for the amount by which the employer's deduction for wages was reduced.

- Delays the sunset of the expensing of environmental remediation expenditures. The Code authorizes taxpayers to treat certain environmental remediation expenditures that would otherwise be chargeable to capital account as deductible in the year paid or incurred. The end of that period of time during which qualifying expenditures can be expensed is extended from January 1, 2001 to January 1, 2002.

- Provides that an option to accelerate the receipt of a payment under a production flexibility contract between the Secretary of Agriculture and a farmer will not accelerate the recognition of income. A taxpayer generally is required to include an item in income no later than the time of its actual or constructive receipt. If a taxpayer has an unrestricted right to demand the payment of an amount, the taxpayer is in constructive receipt of that amount whether or not the taxpayer makes the demand and actually receives the payment. The production flexibility contract payments are to be included in gross income in the year they are actually received. These contracts generally cover crop years 1996 through 2002.

- Prohibits use of the installment method by accrual method taxpayers. Under prior law, the installment method of reporting income from dispositions of property could be used by a taxpayer regardless of whether the taxpayer used the cash method or accrual method of accounting. An accrual method taxpayer is generally required to recognize income when all the events have occurred that fix the right to the receipt of the income and the amount of the income can be determined with reasonable accuracy. The installment method of accounting allows a taxpayer to defer the recognition of income from the disposition of certain property until payment is received, regardless of whether the taxpayer uses the cash method or accrual method of accounting. Public Law 106-170 generally prohibits accrual method taxpayers from using the installment method of reporting income from dispositions of property. It retains the present law regarding the availability of the installment method for dispositions of property used or produced in the trade or business of farming and for dispositions of timeshares or residential lots if the taxpayer elects to pay interest under section 453(l) of the Code. It does not change the ability of a cash method taxpayer to use the installment method.

- Adds new categories of non-capital assets. Three categories have been added to the list of assets the gain or loss on which is treated as ordinary income, as opposed to a capital gain or loss. The new categories are: commodities derivatives held by commodities derivatives dealers, hedging transactions, and supplies of a type regularly consumed by the taxpayer in the ordinary course of the taxpayer's trade or business.

- Limits conversion of character of income from constructive ownership transactions. Public Law 106-170 limits the amount of long-term capital gains a taxpayer can recognize from derivative transactions with respect to certain pass-through entities to the amount of gain the taxpayer would have had if the taxpayer owned a direct interest in the pass-through entity during the term of the derivative contract.

- Delays sunset on transfers of excess pension benefits to retiree health benefits accounts. The period of time permitting qualified transfers of excess defined benefit pension plan

assets to retiree health benefits accounts under section 401(h) of the Code has been extended to include transfers that take place before January 1, 2006. The period of time would have expired on December 31, 2000.

- Allows a basis reduction to assets of a corporation if stock in the corporation is distributed by a partnership to a corporate partner. This reduction applies if, after the distribution, the corporate partner controls the distributed corporation.

- Delays sunset of exceptions under subpart F of the Code for active financing income of controlled foreign corporations. A foreign corporation is a "controlled foreign corporation" (CFC) if more than 50% of its outstanding voting stock, or more than 50% of the value of all its outstanding stock, is owned by U.S. shareholders. A "U.S. shareholder" is a U.S. citizen or resident, or a U.S. corporation, partnership, estate or trust, that owns 10% or more of the foreign corporation's total combined voting stock. In general, the foreign-source income of a foreign corporation is not taxable to its U.S. shareholders until it is distributed to them. Recognizing that income could be accumulated in a CFC, thus deferring U.S. tax on this income indefinitely, Congress enacted the subpart F provisions of the Code in 1962. These provisions require certain items of income to be treated as deemed paid to U.S. shareholders and, therefore, subject to U.S. taxation. The income subject to current inclusion under the subpart F rules includes foreign personal holding company income, insurance income, and foreign base company services income. Examples of foreign personal holding company income include dividends, rents, royalties, annuities, net gains from commodity transactions, net gains from foreign currency transactions, and payments in lieu of dividends. Insurance income subject to inclusion under the subpart F rules includes any income of a CFC attributable to the issuing or reinsuring of any insurance or annuity contract in connection with risks located in a country other than the CFC's country of organization. "Foreign base company services income" is income derived from services performed for a related person outside the country in which the CFC is organized. Temporary exceptions from foreign personal holding company income, foreign base company services income, and insurance income apply for subpart F purposes for certain income that is derived in the active conduct of a banking, financing, or similar business, or in the conduct of an insurance business. These exceptions were set to expire on December 31, 1999. Public Law 106-170 extends these exceptions for two years, until January 1, 2002.

Background for Code Update

Since the State corporate income tax was changed to a percentage of federal taxable income in 1967, the reference date to the Internal Revenue Code has been updated periodically. In discussing bills to update the Code reference, the question frequently arises as to why the statutes refer to the Code on a particular date instead of referring to the Code and any future amendments to it. The answer to the question lies in both a policy decision and a potential restraint.

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

Secondly, and more importantly, however, the North Carolina Constitution imposes an obstacle to a statute that automatically adopts any changes in federal tax law. Article V, Section 2(1)

of the Constitution provides in pertinent part that the "power of taxation … shall never be surrendered, suspended, or contracted away." Relying on this provision, the North Carolina court decisions on delegation of legislative power to administrative agencies, and an analysis of the few federal cases on this issue, the Attorney General's Office concluded in a memorandum issued in 1977 to the Director of the Tax Research Division of the Department of Revenue that a "statute which adopts by reference future amendments to the Internal Revenue Code would … be invalidated as an unconstitutional delegation of legislative power."

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

Conform Pension Tax Withholding

Under federal law, withholding is required on pensions, annuities, and certain deferred income, including IRAs, unless the taxpayer makes an election not to have the tax withheld. There is one exception to this rule: withholding is required on an eligible rollover distribution, and a taxpayer may not elect not to have the tax withheld.[6]

In 1999, the General Assembly passed S.L. 1999-414, which tracks part of the federal law. Under S.L. 1999-414, a pension payer must withhold State income tax on a pension payment, other than an eligible rollover distribution, if the pension payer was withholding federal income tax on the payment. As under federal law, a recipient of a pension payment that is not an eligible rollover distribution may elect not to have tax withheld from the pension payment. Unlike federal law, S.L. 1999-414 did not require that tax be withheld from an eligible rollover distribution. Effective January 1, 2001, this act requires that North Carolina tax be withheld on eligible rollover distributions to the same extent as required under federal law. A taxpayer may not elect not to have the tax withheld. The effect of this change is to conform North Carolina law to federal law in this regard.

Conform Estimated Tax Deadline

The act corrects an inadvertent change made in 1985 by conforming the State's estimated tax deadline for farmers and fishers to the federal deadline. Federal law forgives the penalty for late payment of estimated taxes by farmers and fishers if the final return is filed, with taxes paid in full, by March 1 following the end of the taxable year. Prior State law erroneously based the forgiveness on March 1 payment of estimated tax.

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

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

PAYMENT PENALTIES." The exceptions were intended to remain the same and the Department of Revenue has administered those exceptions in that manner since the federal legislation was enacted.

Clarify Sales Factor

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

The definition of "sales" is the gross receipts of the corporation except for receipts from a casual sale of property and receipts otherwise allocated by statute, such as rents, royalties,

sales of real property, interest, and net dividends. This act clarifies the definition of "sales" by excluding from gross receipts the following:

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

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

Participate in Treasury Offset Program

The Department of Revenue may collect delinquent tax debts owed to the State through the U.S. Department of the Treasury Offset Program. To participate in this method of collection, the State must pay a fee of $9.65 per offset claim to the Program, send a certified letter to the delinquent taxpayer at a cost of $3.01, and incur other incidental expenses. The act enables the Department of Revenue to impose a $15.00 collection assistance fee on each tax debt collected through the Treasury Offset Program. The Department requested the collection fee because of the cost of participating in the Program. The State already imposes a collection assistance fee on debts collected through the State debt setoff collection act. The amount of that fee cannot exceed $15.00. The collection assistance fee authorized by the act is added to the amount of the tax liability submitted to the U.S. Department of the Treasury for setoff. As under the State setoff debt collection act, the collection assistance fee has priority over the debt setoff. Therefore, if the federal setoff covers only part of the tax due, the collection assistance fee has priority over the tax due.

RENEWABLE ENERGY MFR. CREDIT

Session Law #	Bill #	Sponsor
S.L. 2000-128	HB 1473	Representative Hackney

AN ACT TO MODIFY THE INCOME TAX CREDIT FOR MANUFACTURERS OF CERTAIN RENEWABLE ENERGY EQUIPMENT AND TO FURTHER ADJUST THE SHARE CERTAIN CITIES RECEIVE FROM THE STATE GROSS RECEIPTS TAX.

OVERVIEW: This act expands the current corporate tax credit for a corporation that constructs a facility for the production of photovoltaic equipment to include the construction of a facility for the production of other types of renewable energy equipment. The act provides that the credit must be taken in five equal installments and extends the carryforward from five to ten years. The act also adjusts the distribution of the State franchise tax on utility gross receipts that is shared with cities.

FISCAL IMPACT: The current corporate income tax credit for constructing photovoltaic manufacturing facilities has not been used since it was created in 1981. Thus, neither the number of companies nor the amount of the credit to be requested can be estimated. However, if only one company applies for the credit, there will be a General Fund revenue loss due to the absence of applicants for the current tax credit program.

There is no State budget impact from the redistribution of the franchise tax proceeds among the cities.

EFFECTIVE DATE: Section 1 of this act, relating to the tax credit, is effective for taxable years beginning on or after January 1, 2000, and is repealed for costs incurred during taxable years beginning on or after January 1, 2006. Section 2 of the act, relating to the redistribution of the franchise tax, is effective October 1, 2000, and applies to distributions made on or after that date.

BACKGROUND & ANALYSIS:

Tax Credit for Manufacturers of Renewable Energy Equipment

Under prior law, a corporation that constructed a facility for the production of photovoltaic equipment was allowed a credit equal to 25% of the installation and equipment costs of construction paid during the taxable year. The amount of the credit could not exceed the amount of tax owed; any unused credit would be carried forward for five years. Photovoltaic equipment means products designed, manufactured, and produced to convert sunlight directly into electricity. The credit was not allowed to the extent that federal, State, or local grants provide any of the costs of the equipment. To secure the credit, the taxpayer must own or control the facility at the time of construction.

This act allows a corporation that constructed a facility in North Carolina for the manufacture of renewable energy equipment to receive a corporate income tax credit equal to 25% of the installation and equipment costs of construction paid during the taxable year. Renewable energy equipment is defined in the act as biomass equipment, solar electric or thermal equipment, and wind energy equipment. This broad definition encompasses the definition of photovoltaic equipment. As with the prior credit, the new credit is not allowed to the extent that any of the cost of the equipment is provided by governmental grants. The credit allowed under this act differs from the former credit in the following ways:

- The entire credit cannot be taken for the taxable year in which the costs are paid, but must be taken in five equal installments beginning with the taxable year in which the costs are paid.
- The cumulative amount of the credit, including carryforwards, may not exceed 50% of the amount of the tax imposed for the taxable year.
- Any unused portion of the credit may be carried forward for ten years instead of five years.
- A taxpayer that claims any other credit with respect to the construction of a facility to manufacture renewable energy equipment may not take this credit with respect to the same facility.

Adjustment to Franchise Tax Distribution Formula for Cities

This act also makes an adjustment to the franchise tax distribution formula for cities. The State distributes part of the State franchise tax imposed on utilities to the cities. Before July 1, 1999, the franchise taxes that were distributed were the taxes on electricity, piped natural gas, and telephone service. The rate for each utility was 3.22%. In S.L. 1998-22, the General Assembly combined the franchise gross receipts and the sales taxes on piped natural gas into a single per therm excise tax. That act preserved the distribution of the gross receipts tax to cities by providing that 50% of the new excise tax on piped gas service within a city would be distributed to that city.

As part of the resolution of the 1991 State budget crisis, the State eliminated the future growth to cities of this shared revenue. The total amount distributed was frozen but the relative share of each city changed based on the proportion of that city's receipts compared to the total of all cities' receipts. When the 1993 General Assembly restored growth, effective beginning with the 1995-96 fiscal year, it was decided that the State would hold back an amount equal to the growth of the distribution base from 1990-91 to 1994-95 as the contribution of each city to the State's budget problems. After growth was restored in 1995-96, it was discovered that some cities received less net distribution than in 1990-91, the last year prior to the "growth freeze". This happened to cities that experienced a temporary franchise tax base growth in the freeze years (1990-91 through 1994-95) and then a reduction of the base in 1995-96. To adjust for this loss of tax base growth, the 1997 General Assembly reduced the holdback amount, thereby increasing the amount of State franchise tax distributed to 40 cities. These 40 cities were the ones whose 1995-96 distributions were less than 95% of their 1990-91 distributions. The 1997 act increased the annual distribution to the affected cities by a total of $194,841. The annual distribution to the other 500 cities was reduced by the same amount, so that the State share of the franchise tax was not reduced. The 1997 adjustment, however, was not sufficient to hold the Town of Denton's loss to a level that did not go below its 1990-91 distribution. The reason the 1997 adjustment formula did not fully compensate Denton is because the manufacturing facility that was the basis of the holdback had not fully closed by 1995-96.

This act allows the adjustment formula for a city that, in the 1995-96 fiscal year, received from gross receipts taxes less than 60% of the amount it received in the 1990-91 fiscal year, to be based upon the 1999-2000 fiscal year distribution rather than the higher 1995-96 distribution. Based on actual tax base holdback, and distribution data from the Department of Revenue, it is estimated that in future years the Town of Denton will receive an additional $14,000 per year.

This exception to the adjustment formula would apply to distributions made on or after October 1, 2000.

2000 TECHNICAL CORRECTIONS

Session Law #	Bill #	Sponsor
S.L. 2000-140	**SB 1335**	**Senator Hartsell**

AN ACT TO MAKE TECHNICAL CORRECTIONS AND CONFORMING CHANGES TO THE GENERAL STATUTES AS RECOMMENDED BY THE GENERAL STATUTES COMMISSION, TO MAKE OTHER TECHNICAL AND CONFORMING CHANGES, AND TO AMEND LAWS RELATING TO URBAN WATERFRONT DEVELOPMENT AND THE CLASSIFICATION OF GAMMA HYDROXYBUTYRIC ACID (GHB) AS A CONTROLLED SUBSTANCE.

OVERVIEW: This act makes conforming and technical changes to various statutes and session laws. Most of these changes were recommended by the General Statutes Commission. The sections of the act explained in the table below are changes made to the revenue laws and related statutes. These changes were recommended by the Revenue Laws Study Committee, the Department of Revenue, and legislative staff. Additional technical and conforming changes were made in House Bill 1290, enacted as S.L. 2000-173.

FISCAL IMPACT: Insignificant impact.

EFFECTIVE DATE: July 21, 2000, unless otherwise provided *(see Background & Analysis section)*.

BACKGROUND & ANALYSIS: The following table provides a section-by-section analysis of the changes that affect the revenue laws and related statutes:

SECTION	*EXPLANATION*
56	Reorganizes and clarifies new regulatory fee levied in 1999 on certain electric membership corporations.
61	Updates the statute catchline to reflect that the nature of the tax on amusements has changed from a license tax to a privilege tax.
62	Makes conforming change to reflect that natural gas tax is now levied and distributed under a different statute.
63	Corrects wording problems that resulted when two different 1999 acts amended the same statutes.
64	Modernizes outdated language in the corporate income tax statutes.
65	Makes a conforming change to recognize that certain State, local, and federal government retirement benefits are exempt from North Carolina income tax pursuant to settlement of the *Bailey*, *Emory*, and *Patton* cases.
66	Repeals a criminal penalty for willful failure to pay corporate estimated tax, because it duplicates a penalty already provided in

SECTION	EXPLANATION
	G.S. 105-236(9), in the general administrative section of the Revenue Act.
67	Conforms the statute to reflect that only one statewide retail sales tax license is required, reorganizes and consolidates two similar statutes, deletes obsolete language regarding renewal fees, and repeals a criminal penalty that duplicates a penalty already provided in the general administrative section of the Revenue Act.
68	Corrects the form of a reference to the Internal Revenue Code.
69	Adds a definition of "Department" in Chapter 105 of the General Statutes, consistent with the way the term is used in that Chapter to mean "Department of Revenue."
70	Adds the missing word "the" to the statute.
71	Corrects indentation of statute.
72	Corrects a numerical cite in G.S. 105-275, as amended in S.L. 2000-2, and clarifies the definition for the term "vehicle".
73	Makes a conforming change regarding a mailed notice to reflect a 1999 change in the content of property tax lien lists published in the newspapers. This section becomes effective January 1, 2001, the same date the 1999 changes become effective
74	Corrects definitional cross-references to avoid problems when definitions are renumbered.
75	Makes further technical corrections to S.L. 2000-2, effective July 1, 2000.
85	Extends hold harmless period for piped gas distributions to municipalities to allow the Revenue Laws Study Committee more time to evaluate whether the new distribution method enacted in 1998 will yield distribution amounts that are similar enough to those provided under prior law.
88	Corrects effective date for 1999 change to G.S. 105-241.1, the scope of which was inadvertently limited.

FINANCE NEW WILDLIFE CENTERS

Session Law #	Bill #	Sponsor
S.L. 2000-143	**SB 1477**	**Senator Kerr**

AN ACT TO PROVIDE FOR A NEW, SUSTAINABLY DESIGNED, STATE OFFICE BUILDING AND WILDLIFE EDUCATION CENTER WITH RELATED PARKING FACILITIES, TO BE USED BY THE WILDLIFE RESOURCES COMMISSION, PURSUANT TO AN INSTALLMENT FINANCING CONTRACT IN A PRINCIPAL AMOUNT NOT TO EXCEED THIRTEEN MILLION FIVE HUNDRED

THOUSAND DOLLARS, AND TO PROVIDE FOR A NEW EASTERN WILDLIFE EDUCATION CENTER WITH RELATED PARKING FACILITIES, TO BE ADMINISTERED BY THE WILDLIFE RESOURCES COMMISSION, PURSUANT TO AN INSTALLMENT FINANCING CONTRACT IN A PRINCIPAL AMOUNT NOT TO EXCEED FOUR MILLION DOLLARS.

OVERVIEW: This act authorizes the State to construct and finance two projects: a new, sustainably designed, office building and Wildlife Education Center for the Wildlife Resources Commission, to be located in Raleigh, and a new Eastern Wildlife Education Center, to be located in Currituck County. The projects would be financed with one or two installment purchase contracts under which the State would borrow up to $13.5 million for the Raleigh project and up to $4 million for the Currituck County project. Repayment of the debt would be secured by a lien on the building, land, or both.

FISCAL IMPACT: The construction financing costs authorized by this act have no General Fund impact, but rather are borne entirely by the Wildlife Resources Commission (WRC). The WRC expects to fund the construction of the new administration and education center and the Eastern Wildlife Education Center internally, with currently unbudgeted funds. The anticipated yearly loan payment cost of the $13.5 million Raleigh administration and education facility at 5.1% interest for 25 years is $956,495. The annual loan payment for the $4 million Eastern Wildlife Education Center given the same loan term and interest rate is $283,406.

EFFECTIVE DATE: This act became effective August 2, 2000.

BACKGROUND & ANALYSIS: This act would authorize the construction of two projects: a new office building and Wildlife Education Center for the Wildlife Resources Commission in Raleigh and a new Eastern Wildlife Education Center in Currituck County. The Raleigh project would include the 63,000 square foot building, related furnishings and equipment, and parking facilities, and would be located on the Centennial Campus of North Carolina State University. The land would be leased from the Centennial Campus under a long-term lease. The Currituck project would include the 19,800 square foot building, related furnishings and equipment, and parking facilities, and would be located on land adjacent to the Currituck Beach Lighthouse and the historic Whalehead Club. This land is available at no cost from Currituck County.

These two projects would be financed with one or more installment purchase financing contracts. Under such a contract, the State would borrow up to $13.5 million for the Raleigh project and up to $4 million for the Eastern Wildlife Education Center. It is anticipated the amounts borrowed would be repaid with interest in installments over a period of 20 to 25 years. The debt would be tax-exempt. It is the intent of the General Assembly that the repayments would be made not from the General Fund but with funds available to the Wildlife Resources Commission from the Wildlife Resources Fund[7] and the Wildlife Endowment Fund[8].

The debt would be secured by a security interest in the buildings, the land, or both. There would be no pledge of the State's taxing power or full faith and credit. Thus, voter approval is not necessary for the borrowing. If the Wildlife Resources Commission defaulted on its repayments, the buildings could be disposed of to generate funds to satisfy the debt. Under the act, the funds could be borrowed either from a single entity or by the sale of certificates of

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[7] The Wildlife Resources Fund consists of revenues derived from hunting, fishing, and related license fees, other than commercial fishing license fees. The Fund and its earnings are designated for the purposes of the Wildlife Resources Commission. G.S. 143-250.

[8] The Wildlife Endowment Fund consists of the proceeds from the sale of lifetime licenses as well as gifts and grants. The Fund is a special trust fund to support wildlife conservation programs. The earnings of the Fund may be spent for this purpose, while the principal is to be preserved. G.S. 143-250.1.

participation. A certificate of participation represents the holder's undivided interest in the right to receive the installment payments to be made by the State. If certificates of participation are issued, a nonprofit corporation will have to be created to facilitate the financing.

Before a financing contract could be entered into, it would have to be approved by the Council of State. The Council of State would, by resolution, set the maximum interest rate and the maximum number of years over which the debt would be repaid. In addition, the State Treasurer must approve the financing, finding that the amount to be borrowed is adequate and not excessive and will not require an excessive increase in any State revenues to provide for repayment.

It is intended that the Raleigh facility will be sustainably designed, i.e., the building and surrounding environs will be designed using features that are energy efficient, incorporate reusable and renewable resources, provide natural lighting, are nontoxic, require low maintenance, are congruent with the natural characteristics of the site, and cause minimum adverse impact to the environment.

VIDEO POKER MACHINES ILLEGAL

Session Law #	Bill #	Sponsor
S.L. 2000-151	**SB 1542**	**Senator Wellons**

AN ACT TO BAN THE INTRODUCTION OF NEW VIDEO GAMING MACHINES INTO THIS STATE, TO LIMIT THE NUMBER OF VIDEO GAMING MACHINES PER LOCATION, TO PROVIDE FOR REGISTRATION OF MACHINES, INCREASING CRIMINAL PENALTIES FOR VIOLATION, PROVIDING FOR SUSPENSION OR REVOCATION OF LICENSES FOR VIOLATION, AND PROVIDING FOR SEIZURE OF UNLAWFUL VIDEO GAMING MACHINES.

OVERVIEW: This act bans video gaming machines unless they were in lawful operation in the State as of June 30, 2000, and were listed in the State by January 31, 2000, for ad valorem taxation for the 2000-2001 tax year. The act does not ban machines that do not issue replays or redeemable coupons or tokens. The act also prohibits the operation of more than three video gaming machines at one location and requires, subject to a grandfather clause, that locations where video gaming machines are located be at least 300 feet from one another. In addition, the act contains other prohibitions, registration requirements, and reporting requirements, and increases the penalties for violations of the gaming laws. Video machines that give cash payouts are still illegal.

CURRENT LAW: Current law allows the operation of video gaming machines that limit to eight the number of accumulated credits or replays that may be played at one time and that award free replays or paper coupons that may be exchanged for prizes or merchandise with a value not exceeding ten dollars ($10.00), but may not be exchanged or converted to money. Video machines that give cash payouts are illegal.

BILL ANALYSIS: Section 1 of the bill adds a new section (G.S. 14-306.1) that regulates video gaming machines. A video gaming machine is defined as a slot machine as defined in G.S. 14-306(a) and other forms of electrical, mechanical, or computer games, such as video poker, that requires deposit of any coin, token, or use of a credit card, debit card, or any other method that requires payment to activate play. However, the prohibitions contained in G.S. 14-306.1 do not apply to assemblers, manufacturers, and transporters of video gaming machines who assemble, manufacture, and transport them for sale in another state so long as

the machines, while located in North Carolina, cannot be used to play the prohibited games. Nor do the prohibitions apply to those who assemble, manufacture, and sell such machines for the use only by a federally recognized Indian Tribe if such machines may be lawfully used on Indian Land under the Indian Gaming Regulatory Act. Likewise, G.S. 14-306.1 does not make any activities of a federally recognized Indian Tribe unlawful or against public policy if the activities are otherwise lawful for any federally recognized Indian Tribe under the Indian Gaming Regulatory Act.

The new G.S. 14-306.1 makes it unlawful, effective when the bill becomes law, for any person to operate, allow to be operated, place into operation, or keep in that person's possession for the purpose of operation any video gaming machine unless:

- The machine was in lawful operation and available for play within North Carolina on or before June 30, 2000, and was listed in the State by January 31, 2000, for ad valorem taxation for the 2000-2001 tax year; or
- The machine is within the scope of the exclusion provided by G.S. 14-306(b)(1), which is a new subdivision that provides that machines that are operated and played for amusement and that involve the use of skill or dexterity to solve problems or tasks or to make varying scores or tallies and do not emit, issue, display, print out, or otherwise record any receipt, paper, coupon, token, or other form of record which is capable of being redeemed, exchanged, or repurchased for cash, cash equivalent, or prizes, or award free replays are excluded from the definition of slot machines.

Effective October 1, 2000, this section limits to three the number of video gaming machines that a person may operate, allow to be operated, place into operation, or keep in possession for the purpose of operation at one location. Effective October 1, 2000, the following are also prohibited:

- A person under the age of 18 playing a video gaming machine (this violation is an infraction, which is a noncriminal violation of law not punishable by imprisonment).
- An operator of a video gaming machine knowingly allowing a person under the age of 18 to play a video gaming machine.
- The operation or allowing the operation of any video gaming machine during the hours of 2:00 A.M. Sunday through 7:00 A.M. Monday.
- The operation of a video gaming machine that is not in plain view of persons visiting the premises.
- Advertising the operation of video gaming machines by use of on-premise or off-premise signs.

Effective 30 days after the bill becomes law, it is unlawful to warehouse video gaming machines, except in conjunction with the permitted assembly, manufacture, and transportation of these machines.

Effective October 1, 2000, each location where it is lawful to operate video gaming machines must be at least 300 feet in any plane from any other location where other video gaming machines are located. A "location" is defined as a permanent building having or being within a single exterior structure. However, two or more places where video gaming machines were lawfully operated under separate ownership on June 30, 2000, shall be considered to be separate locations more than 300 feet from each other, regardless of the distance from each

other or whether they are located in the same building or edifice. Video gaming machines may be operated only within permanent buildings.

The owner of a video gaming machine must register the machine by October 1, 2000, with the Sheriff of the county in which the machine is located using a standardized registration form supplied by the Sheriff. The registration form must be signed under oath and a material false statement in the registration form shall subject the owner to seizure of the machine under G.S. 14-298 in addition to any other punishment imposed by law. If the video gaming machine is moved to a different location, the owner is required to reregister the machine with the appropriate Sheriff prior to its being placed in operation. The registration form must include, at a minimum, the following:

- Evidence of the date on which the machine was placed in operation.
- The serial number of the machine.
- The location of the facility at which the machine is operated.
- The name of the owner of the facility.

Each Sheriff is required to report to the Joint Legislative Commission on Governmental Operations no later than November 1, 2000, on the total number of machines registered in that county, itemizing how many locations have one, two, or three machines.

The owner of each machine or the agent of that owner must report each calendar quarter to the Department of Revenue the total amount of gross receipts itemized by each machine, the number of machines at that location, and the total value of prizes and merchandise awarded to players of each machine at that location. The first such report is due April 15, 2001. Failure of the owner or agent to timely file the required report, or filing a report containing a material false statement, shall subject the owner of the machine to seizure of the machine under G.S. 14-298 in addition to any other punishment imposed by law. Upon request of a Sheriff, the Department of Revenue shall forward a copy of the report to the Sheriff of the county where the machines are located. The Department of Revenue shall compile the reports and make a summary each quarter to the Joint Legislative Commission on Governmental Operations.

The North Carolina Sheriffs' Association, Inc., after consultation with the Division of Alcohol Law Enforcement, and the Conference of District Attorneys of North Carolina, shall report to the Joint Legislative Commission on Governmental Operations no later than January 1, 2001, its estimates of the costs of the registration process and the cost of enforcement of this section, suggested fees to make the registration and enforcement self-supporting, and recommendations as to a system with registration at the State level and primary enforcement at the local level.

G.S. 14-306.1 explicitly provides that counties and municipalities are not preempted from adopting ordinances that more stringently regulate video gaming machines.

A person who has been convicted once under G.S. 14-309(a) may not possess any video gaming machines for a period of one year. A person who has been convicted twice under G.S. 14-309(a) may not possess any video gaming machines for a period of two years. A person who has been convicted three or more times under G.S. 14-309(a) may not possess any video gaming machines.

<u>Section 2</u> of the bill adds a new section (G.S. 14-306.2) that makes it clear that a violation of G.S. 14-306.1 is a violation of gambling statutes for purposes of G.S. 18B-1005(a)(3). G.S.

18B-1005(a)(3) provides that it is unlawful for an ABC permittee, or his agent or employee, to knowingly allow a violation of the gambling statutes on the licensed premises.

Section 3 amends G.S. 14-309 to make any person who violates any provision of G.S. 14-304 through G.S. 14-309 guilty of a Class 1 misdemeanor for the first offense, guilty of a Class I felony for the second offense, and a Class H felony for a third or subsequent offense. However, a violation of the provisions of G.S. 14-306.1 involving the operation of five or more video gaming machines is a Class G felony.

Section 4 amends G.S. 14-306 to clarify that coin-operated machines, video games, pinball machines and other computer, electronic or mechanical devices operated and played for amusement, that involve the use of skill or dexterity to solve problems or tasks or to make varying scores or tallies and do not emit, issue, display, print out, or otherwise record any receipt, paper, coupon, token, or other form of record which is capable of being redeemed, exchanged, or repurchased for cash, cash equivalent, or prizes, or award free replays are not included in the definition of slot machine.

This section also requires that a video gaming machine that is lawful under G.S. 14-306(b)(2) must have affixed to it in view of the player a sticker informing the player that it is a criminal offense with the potential of imprisonment to pay more than that which is allowed by law. In addition, if the machine has an attract chip that allows programming, the static display shall contain the same message.

This section clarifies that the exemption provided by G.S. 14-306(b)(2) does not apply to a machine that pays off in cash. The exemption provided by G.S. 14-306(b)(2) also does not apply where the prizes, merchandise, credits, or replays are either repurchased for cash or rewarded for cash, exchanged for merchandise of a value more than ten dollars, or where there is a cash payout of any kind by the person operating or managing the machine or the premises, or any agent or employee of that person. Any person making an unlawful payout is subject to punishment under G.S. 14-309.

Section 5 amends G.S. 14-298 to provide that sheriffs and police may seize and destroy any video gaming machine prohibited by G.S. 14-306 or G.S. 14-306.1.

Section 6 directs the Legislative Research Commission to study the implementation of this legislation and recommend any changes it deems necessary in order to strengthen it. The Legislative Research Commission may make its report to the 2001 General Assembly no later than April 1, 2001.

Section 6.1 allows the Department of Revenue to draw from collections under Article 4 of Chapter 105 of the General Statutes for the 2000-2001 fiscal year its actual costs of implementing G.S. 14-306.1(e1), which is the subsection requiring the reporting of the amount of gross receipts itemized by machine and the prizes and merchandise awarded by video gaming machines.

Section 7 contains a severability clause.

Section 8 is the effective date clause. The effective dates of the individual provisions are noted in the text of this summary. The bill becomes law when the Governor signs it.

REALLOCATE WATER BOND FUNDS

Session Law #	Bill #	Sponsor

S.L. 2000-156	SB 1381	Senator Kerr

AN ACT TO REALLOCATE THE PROCEEDS OF THE CLEAN WATER BONDS.

OVERVIEW: This act reallocates $200 million in Clean Water Bonds proceeds from a program that makes loans to local governments, to related grant programs. The act also revises caps on some of the grants, places a moratorium on making grants from one-half of the reallocated proceeds, and requires the State Infrastructure Council to study the geographic distribution of loans and grants from Clean Water Bonds proceeds.

FISCAL IMPACT: Converting some of the loan funds to grant funds will reduce loan repayments credited to the General Fund in an amount estimated to range from about $1 million to $20 million a year between 2001 and 2005.

EFFECTIVE DATE: August 1, 2000.

BACKGROUND: S.L. 1998-132 authorized the issuance of $800 million in Clean Water Bonds. The bonds were approved by the voters in November 1998. Of the $800 million, $300 million was designated for loans to local governments, administered by DENR, to be used for water supply systems, water conservation projects, water reuse projects, wastewater collection systems, and wastewater treatment works. Repayments of the loans are credited to the General Fund. The remaining $500 million of Clean Water Bond proceeds was allocated for various grant programs and to match federal wastewater or water assistance funds. S.L. 1998-132 provided that the $800 in Clean Water Bonds could be reallocated by the General Assembly between the various loan and grant programs designated in the act.

ANALYSIS: This act withdraws $200 million of the $300 million loan funds and reallocates the funds for the following four grant programs that were established in the Clean Water Bonds act:

- $146 million for High Unit Cost Grants. High Unit Cost Grants are grants administered by DENR for wastewater and water system projects that would otherwise require estimated household water and sewer user fees greater than 1.5% of the median household income. These grants are administered under the Clean Water Revolving Loan and Grant Fund.
- $25.9 million for Unsewered Community Grants. Unsewered Community Grants are grants administered by the Rural Economic Development Center for units of local government serving small, rural communities not served by centralized sewer systems for wastewater collection and treatment.
- $28.1 million for Supplemental and Capacity Grants. Supplemental Grants are grants administered by the Rural Economic Development Center to help local governments match other grant or loan funds. Capacity Grants are grants administered by the Rural Economic Development Center to help local governments pay the cost of preparing grant and loan applications, capital improvement plans, and other efforts to support growth and development in rural areas. The act also makes a conforming change to the annual total limits on these Supplemental and Capacity Grants, raising the Supplemental Grant limit from $8 million to $12 million and raising the Capacity Grant limit from $2 million to $3 million.

The act places a moratorium on granting part of the $200 million in bond proceeds reallocated for grants. Only one-half of these funds may be granted before March 31, 2001; the remainder

may be granted after that date. The first one-half of the $146 million reallocated for High Unit Costs Grants is available only to units whose applications were filed with DENR by July 1, 2000. The moratorium was imposed in response to concerns by some local governments that the Clean Water Bond proceeds were being awarded in a manner that favored some geographical areas over others. To address these concerns, the act directs the State Infrastructure Council, an advisory body established in the Clean Water Bond Act, to study the geographic distribution of loans and grants and report any disparities or inequities by December 1, 2000.

Finally, this act modifies the cap on grants made under the Clean Water Revolving Loan and Grant Fund. Under prior law, a unit of local government could not receive grants exceeding $3 million a year. This act reduces the cap to $3 million over three years, except that the cap is not reduced for water districts and sewer districts that include three or more local government units, or for counties in which less than 50% of the population is served by a government or nonprofit public water system. The reduction of the cap on grants will apply to grants made on or after the date the act became law, July 13, 2000, but will take into account grants made on or after July 1, 1999, in determining whether the three-year cap has been exceeded. The purpose of this change was to address concerns by some units of local government that too much of the available funds was going to larger grants to a small number of units.

BROWNFIELDS TAX INCENTIVE

Session Law #	Bill #	Sponsor
S.L. 2000-158	**SB 1252**	**Senator Odom**

AN ACT TO CREATE A TAX INCENTIVE FOR THE REDEVELOPMENT OF BROWNFIELDS PROPERTIES, AS RECOMMENDED BY THE ENVIRONMENTAL REVIEW COMMISSION.

OVERVIEW: This act allows a partial exclusion from property taxes for qualifying improvements made on brownfields property. The partial exclusion is limited to five years and decreases from an exclusion of 90% in the first year to an exclusion of 10% in the fifth year. The Environmental Review Commission recommended this exclusion. Additionally, this act amends the statute governing brownfields agreements so that the Department will give particular consideration to the written comments of units of local government with taxing jurisdiction over property subject to the brownfields agreement.

FISCAL IMPACT: This act does not affect General Fund revenues. The fiscal impact of this act on local government revenues is not clear. However, Department of Environment and Natural Resources staff and numerous county tax assessors feel that the additional property tax revenue provided by improvements to brownfields sites would be far greater than the combined tax loss over the five-year partial exemption period.

EFFECTIVE DATE: The section of this act that established the property tax exclusion becomes effective for taxable years beginning on or after July 1, 2001. The remainder of the act became effective August 2, 2000.

BACKGROUND & ANALYSIS: This act provides that improvements made to real property that is subject to a brownfields agreement will be granted a partial property tax exclusion for the first five taxable years beginning after completion of qualifying improvements made after the later of July 1, 2000, or the date of the brownfields agreement. The property entitled to the exclusion must be appraised annually during the period that the owner is entitled to the exclusion.

The amount of the exclusion declines over the five-year period as follows:

YEAR	PERCENT OF APPRAISED VALUE EXCLUDED
1	90%
2	75%
3	50%
4	30%
5	10%

Additionally, this act amends G.S. 130A-310.34(d) to require the Department of Environment and Natural Resources, when developing brownfields agreements, to give particular consideration to written comment from the local governments having taxing jurisdiction over the brownfields property.

In 1997, the General Assembly enacted The Brownfields Property Reuse Act of 1997. Brownfields property is defined in that act as abandoned, idled, or underused property at which expansion or redevelopment is hindered by actual environmental contamination or the possibility of environmental contamination and that is or may be subject to remediation. Under the 1997 act, the Department of Environment and Natural Resources may enter into a brownfields agreement with a prospective developer. These brownfields agreements allow a developer to clean up a contaminated property to a level that is less "clean" than would otherwise be required by law in exchange for subjecting the property to land-use restrictions. A developer who complies with the agreement will not be held liable for clean-up of areas of contaminants identified in the agreement, so long as the activities conducted on the property do not increase the risk of harm to public health or the environment.

NONHAZARDOUS DRY-CLEANING TECH. INCENTIVE

Session Law #	Bill #	Sponsor
S.L. 2000-160	**HB 1583**	**Representative Gibson**

AN ACT TO PROVIDE AN INCENTIVE FOR INVESTING IN DRY-CLEANING EQUIPMENT THAT DOES NOT USE HAZARDOUS SUBSTANCES AND TO MODIFY THE AUTHORIZATION FOR INVESTING STATE FUNDS IN RURAL NORTH CAROLINA.

OVERVIEW: This act provides a tax credit for commercial dry-cleaners who invest in environmentally friendly dry-cleaning equipment. Additionally, this act modifies the way in which the State Treasurer may invest certain funds held by the State Treasurer. The Environmental Review Commission recommended the dry-cleaning portion of this act.

FISCAL IMPACT: The estimated General Fund loss of the tax credit enacted by this act is as follows:

FISCAL YEAR	FISCAL IMPACT

2001-2002	($584,100)
2002-2003	($423,000)
2003-2004	($507,600)
2004-2005	($625,200)

EFFECTIVE DATE: The tax credit enacted by this act is effective for taxable years beginning on or after July 1, 2001, and is repealed for taxable years beginning on or after January 1, 2006. The remainder of this act became effective August 2, 2000.

BACKGROUND & ANALYSIS: This act adds a new section to Article 3B of Chapter 105 of the General Statutes, which provides tax credits for investing in general business property, renewable energy property, and low-income housing. The new section provides a tax credit for commercial dry-cleaners who buy or lease "qualified dry-cleaning equipment." "Qualified dry-cleaning equipment" is defined as dry-cleaning equipment that does not use any of the following:

- A chlorine-based solvent.
- A hydrocarbon-based solvent.
- A solvent that contains a hazardous substance as defined in the federal Comprehensive Environmental Response, Compensation, and Liability Act.
- A solvent that contains a substance determined by the Environmental Protection Agency or the National Institute of Occupational Safety and Health to possess carcinogenic potential to humans.
- A substance that the Department of Environment and Natural Resources (DENR) determines to pose a threat to human health or the environment.

It is estimated that 99% of the State's dry-cleaners currently use chlorine-based or hydrocarbon-based solvent. Use of these solvents has led to soil and groundwater contamination.

The new credit, which is similar to the renewable energy credit that was enacted in 1999, (*See*: S.L. 1999-342) provides a credit for equipment placed in service in this State equal to 20% of the taxpayer's cost. Like the other credits in Article 3B, this credit may be taken against corporate or individual income tax or corporate franchise tax, at the taxpayer's choice. The total credits allowed under Article 3B may not exceed 50% of the taxpayer's tax liability in any given year. Any excess over this limit may be carried forward for up to five years. Article 3B requires the taxpayer to maintain and make available in case of audit any records necessary to determine and verify the amount of the credit to which the taxpayer is entitled. A taxpayer claiming the credit allowed under the new section must file with the tax return a certification by DENR that the equipment purchased or leased by the taxpayer is "qualified dry-cleaning equipment." No credit is allowed under this section for equipment for which the taxpayer claims another credit under Chapter 105 of the General Statutes.

Section 2 of this act modifies the ways in which the State Treasurer may invest certain State funds. G.S. 147-69.2 sets out the permitted investments for cash in trust funds and special funds held by the State for any purpose other than meeting State appropriations. Under prior law, G.S. 147-69.2 allowed the State Treasurer to invest up to $20 million in the obligations and

securities of the North Carolina Enterprise Corporation. Section 2 expands this authorization to include the North Carolina Economic Opportunities Fund. Since $10 million is currently invested in the North Carolina Enterprise Corporation, the State Treasurer could, but is not required to, invest up to $10 million in the North Carolina Economic Opportunities Fund.

The North Carolina Economic Opportunities Fund is a Small Business Investment Corporation (SBIC). An SBIC is an investment company licensed by the federal Small Business Administration to invest in small businesses. Once licensed, the SBIC can leverage two dollars in federal investment funds for each dollar in non-federal funds invested. The purpose of the North Carolina Economic Opportunities Fund is to provide venture capital for smaller companies in rural North Carolina. Initial financings would typically range from $500,000 to $2 million with investments generally in the form of preferred stock, common stock, or subordinated debts with warrants.

Section 2 of this act also modifies G.S. 147-69.2 to allow the reinvestment in venture capital investments of any income from these venture capital investments without regard to the respective $20 million and $30 million[9] caps. The result of the change is that the State Treasurer could invest substantially more than $50 million in capital projects depending on the economic success of past projects.

The State Treasurer has a fiduciary duty to seek the best possible investments in terms of return and safety. Existing law reflects the policy of the State that the State Treasurer's investment decisions should be professional decisions made in the best interest of the owner of the assets and not influenced by political or economic development considerations. The Treasurer is independent of fiscal control by the Governor and is authorized to contract with independent professionals and experts as necessary for proper administration of the investment programs. The Treasurer is required to establish annual yield targets for investments and to report annually to the General Assembly on the nature and character of all investments, the return on the investments, and the extent to which the annual yield targets have been reached. The Treasurer is also required to report quarterly on all investments to the Joint Legislative Commission on Governmental Operations and to the Co-Chairs of the House and Senate Appropriations Committee

UNC APPROPRIATED CAPITAL/REVENUE BONDS

Session Law #	Bill #	Sponsor
S.L. 2000-168	**HB 1853**	**Representative Miller**

AN ACT TO AUTHORIZE THE CONSTRUCTION AND THE FINANCING, WITHOUT APPROPRIATIONS FROM THE GENERAL FUND, OF CERTAIN CAPITAL IMPROVEMENTS PROJECTS OF THE CONSTITUENT INSTITUTIONS OF THE UNIVERSITY OF NORTH CAROLINA AND TO AMEND THE LAWS REGARDING CERTAIN REVENUE BONDS THAT MAY BE ISSUED BY THE BOARD OF GOVERNORS.

OVERVIEW: This act authorizes the construction of several projects by The University of North Carolina. The projects will be financed through revenue bonds and special obligation bonds, not appropriations from the General Fund.

[9] Currently the State Treasurer may also invest up to $30 million as a limited partner in a partnership whose primary purpose is to invest in venture capital or corporate buyout transactions.

FISCAL IMPACT: The projects authorized by this act will not be constructed with General Fund revenues. However, there are two projects that the institutions will request a General Fund appropriation for operating expenses. The General Fund expenditure for fiscal year 2001-2002 is expected to be $113,179.

EFFECTIVE DATE: The act became effective July 10, 2000.

BACKGROUND & ANALYSIS: There are two types of self-liquidating bonds that may be issued by the Board of Governors of the University of North Carolina: revenue bonds and special obligation bonds. These bonds are not payable from tax revenues. However, the General Assembly must authorize the projects for which special obligation bonds may be issued. Although the statute does not expressly require legislative authorization of revenue bond projects, the General Assembly has historically authorized the projects for many years. This act sets forth the self-liquidating projects the Board of Governors plans to finance with revenue or special obligation bonds this year.

Article 21 of Chapter 116 of the General Statutes authorizes the Board of Governors to issue revenue bonds for the types of projects enumerated in the article. The types of projects for which revenue bonds may be issued include educational buildings, dormitories, recreational facilities, dining facilities, student centers, health care buildings, parking decks, etc. The revenue bonds are payable from rentals, charges, fees, and other revenues such as gifts.

Article 3 of Chapter 116D of the General Statutes, enacted this session by S.L. 2000-3, authorizes the Board of Governors to issue special obligation bonds. Special obligation bonds are payable with any sources of income or receipts of the Board of Governors or a constituent or affiliated institution, but not including tuition payments or appropriations from the General Fund from State revenues. The bond proceeds could be used for construction, improvement, and acquisition of any capital facilities located at UNC constituent and affiliated institutions.

This act also rewrites the existing revenue bond law for clarification purposes. It rewrites the definition of "institution" to recognize that UNC Hospitals at Chapel Hill is now referred to and known as the UNC Health Care System and to include The University of North Carolina General Administration. It rewrites the definition of "project" in the revenue bond law to conform the authority of the Board of Governors to issue revenue bonds for academic facilities to the wording of the authority granted in the special obligation law this year with the passage of S.L. 2000-3.

REFUND OVERPAYMENT OF DEED STAMP TAX

Session Law #	Bill #	Sponsor
S.L. 2000-170	**HB 1544**	**Representative Pope**

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

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

FISCAL IMPACT: No General Fund impact. The bill will affect other funds as follows:

- Parks & Rec. Trust Fund No Impact to Less than $2000 per Year

- Natural Heritage Trust Fund No Impact to Less than $1000 per Year
- Local Government Minimal Impact in Selected Counties

EFFECTIVE DATE: July 13, 2000, and applies retroactively to taxes paid on or after January 1, 2000.

BACKGROUND & ANALYSIS: The excise tax on conveyances, known as the deed stamp tax, is a State tax on instruments transferring an interest in real property. The register of deeds of the county in which the property is located collects the tax when the deed transferring the property is recorded. The person presenting the instrument for recording is responsible for indicating on the instrument the amount of tax due. The register of deeds must collect the tax due and mark on the instrument to indicate payment of the tax and the amount paid. The tax rate is $1.00 for each $500.00 (0.2%) of the value of the property conveyed. The county retains one-half of the net proceeds of the tax and remits the remaining one-half to the State. Seventy-five percent of the funds remitted to the State is dedicated to the Parks and Recreation Trust Fund created in G.S. 113-44.15[10] and 25% is dedicated to the Natural Heritage Trust Fund created in G.S. 113-77.7.[11] None of the State's share of the excise tax on conveyances goes to the General Fund.

The prior law did not provide a mechanism for a taxpayer to receive a refund of an overpayment of the excise tax on conveyances. The tax is governed generally by the administrative provisions in Article 9 of Chapter 105 of the General Statutes. Under Article 9, a taxpayer must apply to the Secretary of Revenue for a refund of an overpayment of tax. However, the State excise tax is administered at the county level, as opposed to the State level. Therefore, the refund procedure in Article 9 did not work well for the excise tax on conveyances.

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

The act provides that the board of county commissioners must review a request for a refund within the time limitations of G.S. 105-266.1. The board must hold a hearing on the request within 90 days after receiving it. The board must make its decision on the request within 90 days after the hearing and it must send a copy of its decision to the Secretary of Revenue. If the board determines that a refund is due, it must refund the county's portion of the overpayment with interest to the taxpayer. If the board determines that a refund is not due, it must inform the taxpayer that the taxpayer may request the Secretary of Revenue to review the decision.

To obtain the Secretary's review of the board's decision, the taxpayer must request a hearing in writing. The request must be filed within 30 days after the taxpayer receives the board of

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[10] The Parks and Recreation Trust Fund is used for capital expenditures for the State Parks System, matching funds for local government park and recreation purposes, and the Coastal and Estuarine Water Beach Access Program.

[11] The Natural Heritage Trust Fund is used to acquire land that represents the ecological diversity of the State, land for State parks, wildlife areas, and similar public purposes, and land that contributes to a balanced State program of historic properties.

county commissioners' decision denying the refund. Like the board, the Secretary must review the request for a refund within 90 days after the Secretary receives the request. The Secretary must send the board a copy of the Secretary's decision. The Secretary's decision is binding on the board of county commissioners. If the Secretary determines that a refund is due, the board must refund the county's portion of the overpayment with interest to the taxpayer.

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

Before the taxpayer may receive a refund, the taxpayer must record a new instrument indicating the correct amount of tax due. If no tax is due because the instrument was recorded in the wrong county, the taxpayer must record an instrument stating that no tax was owed and the reason why. Once the correcting instrument has been recorded, the register of deeds must notify the county finance officer and the Secretary of Revenue so that the overpayment may be refunded to the taxpayer. Like other State taxes, the overpayment bears interest at the rate established in G.S. 105-241.1. The interest begins to accrue on the overpayment 30 days after the taxpayer requests a refund of the tax.

2000 REVENUE LAWS CLARIFYING CHANGES

Session Law #	Bill #	Sponsor
S.L. 2000-173	**HB 1290**	**Representative Luebke**

AN ACT TO IMPROVE THE ADMINISTRATION OF THE TAX LAWS BY MAKING CLARIFYING AND CONFORMING CHANGES TO THE REVENUE AND RELATED LAWS.

OVERVIEW: This act makes numerous clarifying and conforming changes to the revenue laws and related statutes as recommended by the Revenue Laws Study Committee. These changes were originally included in House Bill 1575. Additional conforming and technical changes to the revenue laws were made in Senate Bill 1335, enacted as S.L. 2000-140.

FISCAL IMPACT: Only section 2 of the act has a fiscal impact *(see Background & Analysis section)*.

EFFECTIVE DATE: August 2, 2000, unless otherwise provided *(see Background & Analysis section)*.

BACKGROUND & ANALYSIS: The following table provides a section-by-section analysis of the changes:

SECTION	EXPLANATION
1	Reorganizes the sunsets for the William S. Lee Act and the General Business Credits Act, so that the sunset language will be codified within each Act. Also codifies the William S. Lee Study provisions with the sunset. Codifying the sunsets separates the two Acts' sunsets, which were in the same session law, and makes them easier for taxpayers to find. This section also clarifies the sunset of the Renewable Energy Tax Credits added to the General Business Credits Act in 1999.

SECTION	EXPLANATION
2	Clarifies that the $100 local tax limitation enacted in S.L. 1999-438 for loan agencies and other related businesses does not repeal the pre-existing local authority to tax pawnbrokers up to $275 a year. This section becomes effective July 1, 2001. This section will allow local governments to regain revenue lost due to the 1999 legislation. Based on a 1996 survey of local governments, if all local governments changed their ordinance in response to the 1999 legislation, they would have experienced a loss of $47,999.
3	Clarifies that a county or city does not share in the distribution of beer and wine tax if the only place where beer and wine sales are authorized in the county or city is a sports club. Also repeals an obsolete subsection.
4	Eliminates the requirement that resident breweries, resident wineries, and nonresident vendors file an invoice with the Secretary and that two copies of the invoice be given to wholesalers and importers. The person will still be required to file a report that contains the information required by the Secretary.
5	Conforms the discount statutes for excise taxes on beer, wine, and liquor to those for tobacco products so that they are uniform. The language, that the discount is not allowed on taxpaid beverages given as free goods for advertising, is removed because similar language is not included in the tobacco product article. The Department of Revenue plans to administer the excise tax on tobacco products and the excise taxes on beer, wine, and liquor through the same computer program.
6	Allows the resident breweries, resident wineries, and nonresident vendors to keep information needed to file reports with the Department of Revenue in a format that is useful to them by not restricting them to invoices. These businesses will have to keep records of the information needed to file reports and returns for three years.
7	Repeals the special franchise taxes on telegraph companies and street bus companies. According to the Department of Revenue, there are no taxpayers paying tax under these provisions. With repeal of these special taxes, the general corporate franchise tax will apply to any company that might have otherwise fallen under the provisions of the special taxes.
8	Repeals a cross-reference to the special franchise tax on street bus companies, repealed by section 7 of the act, and reorganizes the language of the statute.

SECTION	EXPLANATION
9	Changes the form of the definition of "manufactured home" in the sales tax law from a restatement of federal standards to a cross-reference to federal standards. This section also codifies an administrative application of the sales tax definition for 'manufactured home" to include a modular home that is built on a permanent chassis and is transportable in one or more sections.
10	Clarifies that a retailer for purposes of the Highway Use Tax must be engaged in the business of selling or leasing motor vehicles, and clarifies and updates definition language in Chapter 20 of the General Statutes.
11	Allows the Department of Revenue to exchange information with the Division of Adult Probation and Parole of the Department of Correction. This change will assist in collecting the controlled substances tax.
12	Clarifies that motor carrier fuel tax assessments based on presumed mileage are used only if the Department of Revenue considers the presumption reasonable. The section also corrects incorrect terminology and changes sentence order.
13	Effective July 1, 2000, changes the method by which tax on fuel is charged at the destination state's rate when the fuel is simultaneously sold from one supplier, to another supplier, to a customer who picks the fuel up at the rack for export. S.L. 1998-146 attempted to address this situation by expanding the definition of two-party exchange to include buy-sell agreements as one type of two-party transaction for purposes of the definition of "supplier". That change created confusion and led to mismatches between terminal operator reports and supplier returns. This section changes back to the old, narrower definition of two-party exchange and then adds a specific provision allowing the destination state's tax rate to be paid when the fuel is transferred at the rack pursuant to a buy-sell agreement.
14	Restores to the definition of "user" a provision that was inadvertently deleted, and makes conforming changes to reflect defined term. This added provision, regarding vehicle weight threshold was formerly provided in G.S. 105-449.9 (repealed). Since users are subject to audit, the vehicle weight threshold will limit the audits to larger vehicles.
15	Conforms the motor fuel excise tax exemption statute to reflect that an unlicensed exporter or distributor is liable for the tax under G.S. 105-449.82(c). This change exempts fuel from the tax only when it is removed by a licensed distributor or licensed exporter.

SECTION	EXPLANATION
16	Conforms the statute catchline by removing a reference to a repealed provision.
17	Incorporates a change concerning "locked pumps" made by the federal law in 1998. The federal change already applies in the State, and the bill simply codifies the change and clarifies that a distributor is still eligible for a refund of the excise taxes paid on kerosene if the pump meets the requirements of federal law. A "locked pump" is one that is kept locked by the retailer and must be unlocked by the retailer for each sale of kerosene. The distributor may currently apply for a refund if the dispensing device for the kerosene is not suitable for use in fueling a highway vehicle.
18	Restores a provision making fuel retailers and bulk-end users subject to audit by the Department of Revenue. S.L. 1999-438 repealed the requirement that retailers and bulk-end users obtain licenses. An unintended consequence of this repeal was elimination of the Department's audit authority over these users and sellers of motor fuel.
19	Moves the tax exemption language for "911" telephone service from G.S. 62A-5 to the corporate income tax statutes. This change makes Articles 1 and 2 of Chapter 62A consistent.
20	Effective date

CONDUIT AGENCY FINANCING

Session Law #	Bill #	Sponsor
S.L. 2000-179	**SB 1472**	**Senator Rand**

AN ACT TO PROVIDE REVENUE BOND FINANCING OF CERTAIN PRIVATE PROJECTS THAT PERFORM A PUBLIC PURPOSE AND TO REORGANIZE THE INDUSTRIAL FACILITIES AND POLLUTION CONTROL FINANCING AUTHORITY.

OVERVIEW: This act provides specific statutory authority for conduit financing of special purpose projects through County Industrial Facilities and Pollution Control Financing Authorities and the North Carolina Capital Facilities Finance Agency. In a conduit financing, a governmental entity issues its bonds to finance facilities for a private party, then receives payments from the private party to service the bonds. The "special purpose projects" that may be financed through conduit financing include:

- Water systems and facilities
- Sewage disposal systems or facilities
- Public transportation systems, facilities, or equipment

- Public parking facilities
- Public auditoriums and similar facilities
- Recreational facilities
- Solid waste facilities
- Facilities for persons with disabilities and for the disadvantaged, such as Goodwill stores and sheltered workshops, but not including retail establishments unless 75% of the inventory is used, donated goods and 75% of the employees will be disadvantaged or disabled persons
- Student housing facilities owned by entities other than educational institutions

FISCAL IMPACT: No fiscal impact.

EFFECTIVE DATE: The act became effective July 1, 2000.

BACKGROUND & ANALYSIS: This act provides specific statutory authority for conduit financing of special purpose projects. In a conduit financing, a governmental entity issues its bonds to finance facilities for a private party, then receives payments from the private party to service the bonds. If the federal tax law permits tax-exempt bond issues for the type of facility financed, the private party is able to borrow at tax-exempt rates

Prior to the enactment of this act, conduit financing was available to a limited extent in North Carolina. County Industrial Facilities and Pollution Control Financing Authorities and the NC Industrial Facilities and Pollution Control Financing Authority can provide conduit agency financing for private industrial and pollution facilities. The NC Educational Facilities Finance Agency can provide conduit financing for educational facilities. Counties and cities may also provide conduit financing directly.

Federal law allows tax-exempt conduit financing for a variety of projects beyond the industrial, pollution control, and educational projects currently authorized in Chapters 159C, 159D, and 115E of the General Statutes. Recent financings have been proposed and entered into for new types of projects, such as recreational facilities to be leased to or operated by a YMCA. The Treasurer's Office had two concerns about the expansion of the type of projects being financed under the prior law. First, although the projects had a public purpose and satisfied federal requirements, the North Carolina statutes did not clearly authorize conduit financing for these types of projects. Second, to the extent the conduit financing was conducted directly by a local government, rather than a special purpose authority, the local government's credit rating was at risk if the private entity were to go into default.

This act addresses the Treasurer's concerns by providing specific statutory authority for conduit financing of special purpose projects. To accomplish this expansion, it makes the following changes regarding revenue bonds issued on behalf of private entities:

- Expands the NC Educational Facilities Finance Agency to become the NC Capital Facilities Finance Agency, and authorizes the agency to issue bonds on behalf of private entities for various projects that have a public purpose ("special purpose projects").
- Authorizes County Industrial Facilities and Pollution Control Financing Authorities to issue bonds on behalf of private entities for various projects that have a public purpose.

- Dissolves the NC Industrial Facilities and Pollution Control Financing Authority and transfers its powers and duties to the NC Capital Facilities Finance Agency.

"Special purpose projects" encompass a variety of private, public purpose projects. The types of projects that the act gives County Industrial Facilities and Pollution Control Financing Authorities and the NC Capital Facilities Finance Agency the power to finance are:

- Water systems and facilities
- Sewage disposal systems or facilities
- Public transportation systems, facilities, or equipment
- Public parking facilities
- Public auditoriums and similar facilities
- Recreational facilities
- Solid waste facilities
- Facilities for persons with disabilities and for the disadvantaged, such as Goodwill stores and sheltered workshops, but not including retail establishments unless 75% of the inventory is used, donated goods and 75% of the employees will be disadvantaged or disabled persons

Student housing facilities owned by entities other than educational institutions would also be authorized for the Capital Facilities Financing Agency. Under prior law, the NC Educational Facilities Financing Agency could provide conduit financing for student housing facilities owned or operated by an educational institution. The inclusion in this act of student housing that is not owned or operated by an educational facility addresses current proposals to finance private, nonprofit housing for students at various universities, including Appalachian State University, Fayetteville State University, and North Carolina Agricultural and Technical State University.

The act renames the NC Educational Facilities Finance Agency and it recodifies its statutes from Chapter 115E of the General Statutes to Article 2, of Chapter 159D of the General Statutes to reflect the broader financing authority given to it under this act. Besides educational facilities, the authority, renamed the NC Capital Facilities Finance Agency, may provide conduit financing for special purpose projects. One reason for the expansion of this authority is to allow it to provide conduit financing for multi-county projects, such as a proposed multi-county recreational facility to be operated by a YMCA near Winston-Salem. Industrial Facilities and Pollution Control Financing Authorities created by county governments have limited ability to finance multi-county projects.

The act also authorizes the NC Educational Facilities Finance Agency to take over the remaining responsibilities of the NC Industrial Facilities and Pollution Control Financing Authority, which is dissolved under this act. The Industrial Facilities and Pollution Control Financing Authority, created under Chapter 159D of the General Statutes, is a State entity that issued bonds in the late 1980s and early 1990s for purposes similar to those provided for County Industrial Facilities and Pollution Control Financing Authorities. The State authority is moribund at this time due to the loss of records regarding its creation and membership. However, administrative duties regarding its outstanding bonds continue to arise from time to time. Although additional bonds are not expected to be issued under Chapter 159D for industrial or pollution control projects, the act makes a few changes to conform the provisions to those governing County

Industrial Facilities and Pollution Control Financing Authorities in Chapter 159C, and to delete obsolete provisions.

Under the act, a private entity (either nonprofit or for-profit) could obtain financing from a County Industrial Facilities and Pollution Control Financing Authority or from the North Carolina Capital Facilities Finance Agency in order to acquire, construct, and improve a special purpose project. The act authorizes both the initial financing of special purpose projects and the refinancing of pre-existing debt for special purpose projects. The financing would usually be tax-exempt under federal law and could include revenue bonds or other forms of debt, but would not include any financing that pledges the faith or credit of the State, a local government, or any political subdivision. The advantage to private entities of tax-exempt financing is that interest rates on tax-exempt financing are significantly lower than on taxable financing. The private entity must pay for the entire cost of the financing and of the facility being financed.

Besides providing tax-exempt financing for capital facilities for special purpose projects, conduit financing may cover land acquisition, landscaping, site preparation, furniture, and machinery and equipment, as well as engineering and architectural services and other administrative expenses related to construction or acquisition of a project. Financing from the Capital Facilities Finance Agency is not available for projects that discriminate based on race, creed, color, or national origin. The law governing County Industrial Facilities and Pollution Control Financing Authorities does not contain a similar restriction.

Conduit financing through the State would be administered by the Capital Facilities Finance Agency, which is located in the Department of State Treasurer. The Agency has seven members: the State Treasurer, the State Auditor, one member appointed upon the recommendation of the President Pro Tempore of the Senate, one member appointed upon the recommendation of the Speaker of the House of Representatives, and three members appointed by the Governor. The appointive members must be residents of North Carolina and cannot hold other public office. The Agency is audited annually and submits an annual report to the Governor and the General Assembly.

A private entity could qualify for financing only if the Agency found it to be financially responsible and capable of fulfilling its obligations. Before financing is approved, the Agency must find that the entity has provided adequately for the payment of principal and interest on the bonds and for the operation, repair, and maintenance of the facility to be financed. The act clarifies that the Agency, in making this finding, may consider whether the private entity on behalf of whom the bonds will be issued has arranged for delivery of a letter of credit or for any other credit enhancement to secure the obligations. Similar provisions are found in the current law governing County Industrial Facilities and Pollution Control Financing Authorities.

Public notice and a public hearing are required before the bonds may be approved. The governing body of the county, and of any municipality, in which the project will be located must be notified of the hearing.

The Agency may issue bonds only if the Local Government Commission approves them. The Local Government Commission sets the interest rates on the bonds and administers their sale. The bonds may be secured by a trust agreement with a corporate trustee, such as a bank. The Agency will require the private entity to pay fees, loan repayments, rents, or other charges sufficient to cover the payment of principal and interest on the bonds and the operation, repair, and maintenance of the facility to be financed, and the bonds will be secured by the pledge of these revenues.

1999

ELIMINATE STAMPS FOR DEED TAX

Session Law #	Bill #	Sponsor
S.L. 1999-28	HB 56	Representative Hill

AN ACT TO ELIMINATE THE USE OF STAMPS TO INDICATE WHETHER THE EXCISE TAX ON CONVEYANCES HAS BEEN PAID AND TO MAKE THE PENALTIES THAT APPLY TO THIS TAX THE SAME AS FOR OTHER TAXES.

OVERVIEW: *This act eliminates the requirement that tax stamps be used to indicate whether the excise tax on conveyances has been paid. It also makes the penalties for failure to pay the tax the same as for other taxes.*

FISCAL IMPACT: The act will not affect local or State revenues significantly.

EFFECTIVE DATE: July 1, 2000.

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

Under prior law, the Register of Deeds had to use tax stamps to indicate the tax had been paid. This act removes the requirement that tax stamps be used to indicate the tax has been paid. Tax stamps are no longer the best method for tracking payment of the conveyance tax now that metering machines and similar equipment are available. About 85 of the 100 counties have switched from stamps to more modern methods of tracking the tax. The act does not prohibit a county from using stamps to indicate that the tax has been paid. However, effective July 1, 2000, the Department of Revenue will no longer be responsible for ordering and maintaining an inventory of various denominations of stamps to sell to the counties that choose to use them.

The act continues the work the legislature began last session when it amended several sections of the Revenue Act to make tax penalties uniform by providing that the civil and criminal penalties applicable to all other State taxes apply to the conveyance tax. Under prior law, willful evasion of the tax was a Class 3 misdemeanor punishable by a fine of between $100 and $1,000. The general penalty contained in Article 9 of Chapter 105 for failure to pay the tax due is 10% of the amount of tax due. The penalty for willfully failing to pay the correct amount of tax due is a Class 1 misdemeanor. Attempting to evade a tax due is punishable as a Class H felony.

The Revenue Laws Study Committee, upon the recommendation of the Department of Revenue recommended this legislation.

CONTINUING CARE RETIREMENT HOMES

Session Law #	Bill #	Sponsor
S.L. 1999-191	**SB 325**	**Senator Hoyle**

AN ACT TO MAKE CORRECTIONS AND CONFORMING CHANGES RELATING TO TAXATION OF CONTINUING CARE RETIREMENT HOMES.

OVERVIEW: *The act makes corrections and conforming changes to the 1998 legislation that temporarily revised a property tax exemption for continuing care retirement centers (CCRCs), which had been held unconstitutional in 1998. The act makes the following changes retroactive to the 1998 tax year:*

- Removes an unconstitutional grandfather clause from the exemption.
- Clarifies that the entity that selects the governing board of the nonprofit CCRC may be a corporation or an unincorporated association.
- Provides that the entity that selects the governing board of the nonprofit CCRC may be a charitable organization, a fraternal beneficiary association, or a domestic fraternal association.
- Discourages counties and cities from collecting prior years' taxes on exempt CCRCs on or after January 1, 1998.

FISCAL IMPACT: Insignificant impact.

EFFECTIVE DATE: Changes are retroactive to the 1998 tax year.

BACKGROUND & ANALYSIS: In 1998, the General Assembly exempted from property tax those CCRCs whose governing body is not self-perpetuating but is selected by another publicly supported charitable nonprofit. That act effectively restored the exemption for those CCRCs that were exempt under the law struck down by the North Carolina Supreme Court[1], but retained taxability of those CCRCs that had been taxed all along. It did not affect charitable homes for the aging, which were already exempt and were not affected by the court case.

While the 1998 legislation was in committee, an amendment was added limiting the exemption to those CCRCs who met the definition as of a certain date. Such a grandfather clause in a property tax provision is not a valid classification under the North Carolina Constitution. After the law was enacted, the Institute of Government noted the unconstitutional grandfather clause, and some counties determined that they would not recognize the exemption because it had this unconstitutional provision. This act removes the unconstitutional grandfather clause that limited the property tax exemption to CCRCs whose charter or bylaws met the definition on August 15, 1998.

The act also expands the definition of the appointing entity to include associations and fraternal entities. To qualify for the property tax exemption under the 1998 law, the governing board of the CCRC had to be appointed by a publicly supported charitable 501(c)(3). After the 1998

[1] In re Springmoor, 348 N.C. 1 (1998).

legislation was enacted, some CCRCs determined that their boards were appointed by nonprofit associations, rather than corporations, and that some of these nonprofits were fraternal (501(c)(8) and (10)) rather than charitable.

The act removes the financial incentive for assessing retroactive taxes on exempt CCRCs. It does so by reducing the annual State reimbursement to a county or municipality for the repeal of the intangibles tax by 110% of the amount of taxes collected in that year on exempt CCRCs for a year prior to the 1998 tax year. This part of the act is repealed effective September 1, 2003, because the five-year discovery period will have expired then.

Lastly, the act authorizes the Legislative Research Commission to study the issue of property tax exemptions for nonprofits and directs the Legislative Research Commission to report its findings and recommendations to the 2000 Session of the 1999 General Assembly. On August 25, 1999, the Legislative Research Commission referred this issue to the Revenue Laws Study Committee.

REAL PROPERTY TAX PENALTY

Session Law #	Bill #	Sponsor
S.L. 1999-297	**SB 817**	**Senator Ballance**

AN ACT TO PROVIDE AN EXCEPTION TO THE LATE LISTING PENALTY FOR CERTAIN REAL PROPERTY IN COUNTIES THAT HAVE NOT ADOPTED PERMANENT LISTING AND TO PHASE IN PERMANENT LISTING IN ALL COUNTIES.

OVERVIEW: *This act requires the board of county commissioners of each county to install a permanent listing system.* (Note: *The act only applies to the following six counties: Clay, Graham, Swain, Vance, Warren, and Yancey.) It also provides that the 10% late listing penalty will not apply to property that has not been improved or transferred since it was last listed.*

FISCAL IMPACT: Insignificant impact.

EFFECTIVE DATE: Each of the six counties affected must have a permanent listing system for taxable years beginning on or after July 1, 2004. The prohibition on imposing the 10% late listing penalty is effective for taxes imposed for taxable years beginning on or after July 1, 1999 and sunsets July 1, 2004.

BACKGROUND & ANALYSIS: There are only six counties that have not adopted a permanent listing system for property tax purposes: Clay, Graham, Swain, Vance, Warren, and Yancey. Under a permanent listing system, the assessor rather than the owner is responsible for listing all real property for property tax purposes. The owner of the property does not need to respond to the listing form unless the property has been improved or transferred since the last listing. The 10% late listing penalty does not apply to property listed under a permanent listing system. However, the penalty does apply if the taxpayer fails to furnish the assessor with information concerning improvements to the property not reflected on the listing form.

To encourage counties to install a permanent listing system as soon as possible, the act provides that, effective for taxes imposed for taxable years beginning on or after July 1, 1999, the 10% late listing penalty will not apply to property that has not been improved or transferred since it was last listed. The prohibition on imposing the late listing penalty sunsets July 1, 2004. The late listing penalty applies to property that should have been listed for tax purposes but is not. When the property is "discovered", the property is taxed for the year it was discovered and the preceding five years it escaped taxation. Each year's taxes are computed separately.

A late listing penalty equal to 10% of the amount of the tax for the earliest year the property was not listed is added to the amount of tax due. The penalty is computed separately for each year the failure to list occurred.

TECHNOLOGY COMMERCIALIZATION CREDIT

Session Law #	Bill #	Sponsor
S.L. 1999-305	**SB 1110**	**Senator Rand**

AN ACT TO PROVIDE AN INCENTIVE FOR BUSINESSES TO FIND COMMERCIAL USES FOR TECHNOLOGY DEVELOPED BY RESEARCH UNIVERSITIES.

OVERVIEW: This act adds a new investment tax credit, the technology commercialization credit, to the William S. Lee Quality Jobs and Business Expansion Act, effective for taxable years beginning on or after January 1, 2000.[2]

FISCAL IMPACT: Beginning with the 2000-2001 fiscal year, the maximum General Fund revenue loss is expected to be $2.1 million per year.

EFFECTIVE DATE: Effective for taxable years beginning on or after January 1, 2000.

BACKGROUND & ANALYSIS: The new investment tax credit is an alternative to the existing 7% tax credit for investing in machinery and equipment. The technology commercialization credit applies only to investments in machinery and equipment used in production based on technology licensed from a research university. In addition, to qualify, the machinery and equipment must be located in a tier one, two, or three enterprise area. Finally, the taxpayer's investment must equal at least $10 million during the taxable year, and must total at least $100 million over a five-year period. If the investment totals between $100 million and $150 million over five years, the technology commercialization credit is equal to 15% of the amount invested. If the investment equals or exceeds $150 million over five years, the technology commercialization credit is equal to 20% of the amount invested. The technology commercialization credit remains available for 10 years of investments at a single location. The taxpayer's eligibility for the technology commercialization credit is based on the Secretary of Commerce's certification that the taxpayer will invest either $100 or $150 million over five years. If the taxpayer does not achieve the certified level of investment, the credit is forfeited. As for the existing investment tax credit, forfeiture of the credit triggers forfeiture of any worker training credit taken for training workers to operate the new machinery and equipment.

The technology commercialization credit is more generous than the existing investment tax credit under the William S. Lee Act in the following ways:

- The existing investment tax credit is 7% of the amount invested. The technology commercialization credit is 15% or 20% of the amount invested, depending upon the size of the investment.

[2] The William S. Lee Quality Jobs and Business Expansion Act, enacted by the General Assembly in 1996, was designed to promote economic development throughout the State by providing various business tax credits. These credits were expanded by the General Assembly in S.L. 1997-277, S.L. 1998-55, and S.L. 1999-360.

- The existing investment tax credit must be taken in seven annual installments beginning the year after the year the investment is placed in service. The technology commercialization credit may be taken in the year the investment is placed in service.
- The existing investment tax credit applies only to the extent the new investment is not offset by the amount of machinery and equipment the taxpayer either sold or took out of service in the three-year period before the new investment was placed in service. This restriction limits the existing credit to net increases in North Carolina investment, and disallows it for investments that are in effect a replacement or relocation of pre-existing machinery and equipment. The technology commercialization credit is not required to be offset by machinery and equipment sold to another taxpayer if the new owner keeps the machinery and equipment in service in North Carolina. In addition, this new investment tax credit is not required to be offset by machinery and equipment the taxpayer takes out of service if it was in service at a separate location and was used in a business that is not competitive with the technology commercialization business.
- The existing investment tax credit, like all other William S. Lee Act credits, may be taken against the taxpayer's income tax or franchise tax, but not both. The technology commercialization credit may be taken against both income tax and franchise tax. The taxpayer must determine what percentage of the credit will be taken against each tax, and must maintain the same percentage for the purpose of carryforwards. If new investment is made in a second or subsequent tax year, the taxpayer may elect a different percentage with respect to the credit for each tax year. The election is binding.
- The existing investment tax credit, like all other William S. Lee Act credits, may be carried forward for five years unless the investment amount exceeds $150 million over a two-year period, in which case it may be carried forward for 20 years. The technology commercialization credit may be carried forward for 20 years.

ZERO ESC TAX/TRAINING CONTRIBUTION

Session Law #	Bill #	Sponsor
S.L. 1999-321	**HB 275**	**Representative Redwine**

AN ACT TO IMPLEMENT A ZERO UNEMPLOYMENT INSURANCE TAX RATE FOR MORE EMPLOYERS WITH POSITIVE EXPERIENCE RATINGS, AND TO TEMPORARILY REDUCE THE UNEMPLOYMENT INSURANCE TAX BY TWENTY PERCENT FOR MOST EMPLOYERS AND SUBSTITUTE AN EQUIVALENT CONTRIBUTION TO FUND ENHANCED EMPLOYMENT SERVICES AND WORKER TRAINING PROGRAMS.

OVERVIEW: This act makes two changes to unemployment insurance taxes:

- It changes the minimum credit ratio of employers who are granted a zero tax rate from 5% to 4%, effective April 1, 1999.
- It temporarily reduces unemployment insurance taxes for most employers by 20% and levies a corresponding contribution to be used for enhanced reemployment services and worker training programs, effective January 1, 2000. The rate of contribution is the lesser of 20% or a percentage that yields an amount that, when combined with the

employer's unemployment insurance taxes, is no greater than the amount of tax the employer would have paid under existing law. These changes will sunset in two years.

FISCAL IMPACT: *See Background & Analysis section.*

EFFECTIVE DATE:

Minimum credit ratio change	April 1, 1999
Reduce UI Tax/Reemployment fund contribution Sunset January 1, 2002	January 1, 2000;

BACKGROUND & ANALYSIS:

Minimum Credit Ratio Change. In 1995, the General Assembly set a zero unemployment insurance tax rate for employers with credit ratios of 5% or greater. This act allows more employers to have a zero unemployment tax rate by lowering the threshold from 5% to 4%. The credit ratio is the ratio of an employer's credit balance in the Unemployment Insurance (UI) Fund relative to the employer's payroll. The UI Fund is maintained by the U.S. Treasury and funded by the State unemployment insurance tax. This part of the act is effective with respect to calendar quarters beginning on or after April 1, 1999. The Employment Security Commission (ESC) recommended this change due to the solvency of North Carolina's UI Fund and the increasing stability of labor markets. As of April 30, 1999, the balance in the Unemployment Insurance Trust Fund stood at $1.22 billion. In addition, a reserve fund contains an additional $200 million, due to the Fund's solvency and North Carolina's low unemployment rate. ESC estimates this change will affect over 10,000 employers, with a tax savings to employers of over $1,000,000 in the first year. With an additional 6,400 employers reaching the 4% credit ratio each year, ESC estimates that 38,000 employers will benefit from this zero tax rate by 2004.

Reduce UI Tax/Reemployment Fund Contribution. The act also reduces the unemployment insurance taxes employers pay to the Employment Security Commission. The reduction is 20% for most employers, slightly less for new employers, and less for roughly 3,400 employers with a high debit ratio. Those employers who pay at a zero tax rate are not affected by this change. The act levies a new tax equal to a percentage of each employer's unemployment insurance tax. The tax is called a "training and reemployment contribution." The percentage rate of the contribution is the lesser of 20% or a percentage that yields an amount that, when combined with the employer's reduced UI tax, is no greater than the amount of UI tax the employer would have paid under the prior law. Thus, when the UI tax reduction and the new contribution are netted, all employers will pay the same or slightly less. These changes become effective January 1, 2000, and sunset January 1, 2002.

It is estimated that the new contribution will generate $22.9 million in FY 1999-2000 and $60.8 million in FY 2000-2001. The new contribution will be credited to a non-reverting account subject to appropriation by the General Assembly. The account is called the "Employment Security Commission Training and Employment Account." The act states the intent of the General Assembly that 4/5 of the proceeds will be appropriated annually from the account to the Department of Community Colleges for nonrecurring expenditures for various worker training programs. The act amends *The Current Operations and Capital Improvements Appropriations Act of 1999* to appropriate from the Employment Security Commission Training and Employment Account to the Community Colleges System Office the sum of $18 million for the 1999-2000 fiscal year and the sum of $48.5 million for the 2000-2001 fiscal year. The act states the intent of the General Assembly that the remaining 1/5 of the proceeds will be appropriated annually from the account to the Employment Security Commission for the costs of collecting and administering the new contribution, and for nonrecurring expenditures for enhanced

reemployment services. The act amends the budget bill to appropriate from the Account to the Employment Security Commission the sum of $4.5 million for the 1999-2000 fiscal year and the sum of $12.1 million for the 2000-2001 fiscal year.

Unemployment insurance taxes are paid by employers on a quarterly basis and deposited into the State Unemployment Insurance Trust Fund. After deducting any refunds payable from the Fund pursuant to G.S. 96-10(f), the money is deposited with the secretary of the treasury of the United States to the credit of this State's account in the Unemployment Trust Fund. Funds in the State's account earn interest that is also credited to the account. As money in the State's account is needed to pay benefits, it is transferred to the State and credited to the benefits account of the State's Unemployment Insurance Fund to be used to pay benefits to people who lose their job through no fault of their own. Federal law prohibits transfer of or payment of refunds from money in the Trust Fund.

The General Assembly reduced unemployment insurance tax rates in recent years because the balance in the federal trust fund was higher than needed to pay benefits. The tax rates will automatically double when the trust fund balance falls below $800 million. By reducing the unemployment insurance tax rates by 20% for two years, the changes made by this act could cause the balance in the trust fund to fall faster, triggering an automatic tax increase earlier than might otherwise occur. On the other hand, it is hoped that the enhanced reemployment services funded by the new contribution would shorten the average period before a worker is reemployed, thereby reducing benefit payments for the trust fund. The new contribution would sunset automatically if a drop in the trust fund balance triggered an unemployment insurance tax increase.

History of UI Fund Reductions. Since 1992, the General Assembly has enacted the following **legislation to reduce the amount of money in the Unemployment Insurance Fund:**

- **1992 -** suspended the 20% surcharge on unemployment taxes.
- **1993 -** cut unemployment taxes for positive rated employers by an average of 30% for any calendar year in which the balance in the Fund equals or exceeds $800,000,000.
- **1994 -** cut the unemployment taxes for positive rated employers by an average of 38.7% and cut the unemployment taxes for new employers by 20%.
- **1995** - cut the unemployment taxes for positive rated employers by an average of 23%, set a zero rate for employers with credit ratios of 5.0 or over, and reduced from 60% to 50% the percentage of annual average wages used to calculate the taxable wage base.
- **1996** - reduced unemployment taxes in three ways by (1) assigning a one-year zero unemployment insurance tax rate for all positive rated employers, (2) giving overdrawn employers additional time to make contributions to their accounts so that they may qualify for the zero tax rate in 1996, and (3) permanently reducing the tax rate for new employers from 1.8% to 1.2%.

INTANGIBLES TAX SETTLEMENT

Session Law #	Bill #	Sponsor

S.L. 1999-327	SB 1043	Senator Rand

AN ACT TO PROVIDE FUNDS TO MEET THE REQUIREMENTS OF A CONSENT JUDGMENT UNDER THE INTANGIBLES TAX CASES.

OVERVIEW: This act approves a settlement agreement executed by the Speaker of the House of Representatives and the President Pro Tempore of the Senate on July 8, 1999, in settlement of Smith, et al. v. State, 95 CVS 06715 and Shaver, et al. v. State, 98 CVS 00625. These cases were initiated by taxpayers who paid intangibles tax on stocks for tax years 1990, 1991, 1992, 1993, and 1994, without protesting the payment in a timely manner. The act also appropriates the funds necessary for the refunds.

Fiscal Impact:

- Appropriates $200 million on October 1, 1999, from the Savings Reserve Account for fiscal year 1999-2000 to a settlement fund to pay tax refunds claimed by the above taxpayers.
- Directs the General Assembly to allocate the remaining $240 million to the settlement fund by July 10, 2000.

EFFECTIVE DATE: July 20, 1999.

BACKGROUND & ANALYSIS: On July 8, 1999, a settlement agreement was signed by the President Pro Tempore of the Senate, the Speaker of the House of Representatives, and the Class Counsel for the plaintiffs in two pending lawsuits dealing with the question of when refunds should be paid to taxpayers who paid intangibles tax on stocks for the 1990-94 tax years and who did not timely protest payment of this tax. The agreement was in response to two Superior Court of Wake County decisions regarding nonprotester refunds. On May 25, 1999, the superior court held the State liable for $360 million of refunds and interest for the 1991-94 tax years in Smith, et al. v. State of North Carolina, 95 CVS 06715.[3] In a more recent decision, the superior court held that the State was liable for $110 million in refunds and interest for the 1990 tax year in Shaver, et al. v. State, 98 CVS 00625.

On the same day as the July 8, 1999, settlement agreement, the Superior Court of Wake County entered a consent order tentatively approving the settlement agreement. The consent order provides for the following:

- The General Assembly will appropriate $440 million to a settlement fund over the next two years:
    1. The General Assembly must allocate $200 million to the fund before October 1, 1999. This money will be drawn from the Savings Reserve Account.
    2. The General Assembly must allocate the remaining $240 million to the fund by July 10, 2000.

[3] This decision was issued by the superior court on remand from the North Carolina Supreme Court decision in Smith et al. v. State, 349 N.C. 332 (1998). The Supreme Court held that the trial court erred in dismissing the claims of individuals who paid the intangibles tax for the years in question but did not give notice challenging the legality of the tax. The Court remanded the case to the superior court to determine the details.

- Within the Settlement Fund, 85% of the funds will be allocated to the "Smith/Shaver Claims Fund Account" and 15% will be allocated to the "Smith/Shaver Administration Account". Interest and earning on all proceeds will be added as principal to the taxpayers' Claims Fund Account.
- The class counsel under the supervision of the court will administer the Settlement Fund.
- No disbursement will be made from the Claims Fund Account until after August 1, 2000.
- Class members will be provided full notice of the terms of the settlement agreement and their rights.
- The State is immune from any further liability for claims brought by taxpayers regarding the payment of intangibles tax on shares of stock under the repealed G.S. 105-203. This statute imposed an intangibles tax on shares of stock and provided a taxable percentage deduction reducing a taxpayer's liability for this tax in proportion to the issuing company's income taxed in North Carolina. In 1997, the North Carolina Supreme Court held the statute unconstitutional because it violated the commerce clause by discriminating against out-of-state companies.
- The Class Counsel will be developing a timetable for implementing the refund procedures and payment to individual taxpayers.

Pursuant to the terms of the above consent order, the act provides for the following appropriations:

- $200 million is appropriated from the Savings Reserve Account for the 1999-2000 fiscal year to the Department of the State Treasurer on October 1, 1999. This sum is to go to a reserve for the Smith/Shaver cases and is to be held in reserve for allocation pursuant to the above consent order. The act states the intent of the General Assembly to restore to the Savings Reserve Account the sum of $200 million during the 2000-2001 fiscal year.
- An additional $240 million is allocated no later than July 10, 2000, in accordance with the above consent order.

PHASE II FUNDS/IMMUNITY/TAX EXEMPT

Session Law #	Bill #	Sponsor
S.L. 1999-333	**HB 74**	**Representative Baker**

AN ACT TO AUTHORIZE THE APPOINTMENT BY THE SPEAKER OF THE HOUSE OF REPRESENTATIVES AND THE PRESIDENT PRO TEMPORE OF THE SENATE OF MEMBERS OF THE BOARD OF DIRECTORS OF THE CERTIFICATION ENTITY FOR THE PHASE II SETTLEMENT FUNDS, TO PROVIDE THE MEMBERS OF THE BOARD OF DIRECTORS LIMITED IMMUNITY FROM CIVIL LIABILITY, TO PROVIDE AN EXEMPTION FROM STATE INCOME TAX FOR INTEREST, INVESTMENT EARNINGS, AND GAINS OF CERTAIN TRUST FUNDS, TO PROVIDE A CORPORATE INCOME TAX CREDIT FOR MANUFACTURERS PRODUCING CIGARETTES FOR EXPORTATION TO A FOREIGN COUNTRY, AND TO PROHIBIT THE SALE OF CERTAIN PACKAGES OF CIGARETTES.

Overview: The act does the following:

- Board of Directors. It provides for the appointment of the board of directors of a nonprofit corporation that will be the certifying entity to distribute money to tobacco growers and allotment holders in North Carolina. Pursuant to an agreement among four tobacco manufacturers, the manufacturers will pay the sum of $5.15 billion into the National Tobacco Grower Settlement Trust over a twelve-year period. This trust will provide payments to tobacco growers and allotment holders in fourteen grower states, including North Carolina. This money, referred to as Phase II settlement funds, will be used to ameliorate potential adverse economic consequences of likely changes in the tobacco market on grower states. This provision became effective July 22, 1999.

- Board of Directors' Immunity. It provides immunity to the board of directors for certain acts or omissions arising out of the performance of the member's duties as a member of the nonprofit corporation. This provision became effective July 22, 1999.

- Income Tax Exemption. It provides an income tax exemption for the interest, investment earnings, and gains of a trust that is established to compensate those who suffer economic loss as a result of a settlement agreement between the State and one or more manufacturers to settle claims of the State against the manufacturers for damages arising from a product of the manufacturers. This change is effective for taxable years beginning on or after January 1, 1999.

- Corporate Income Tax Credit. It creates a corporate income tax credit for manufacturers who produce cigarettes for exportation to a foreign country. The amount of the credit varies depending upon the amount of cigarettes exported in the tax year compared to the amount exported in 1998. This credit is effective for taxable years beginning on or after January 1, 1999, and sunsets for cigarettes exported on or after January 1, 2005.

- Unlawful to Sell Certain Cigarettes. It makes it unlawful to sell cigarettes in North Carolina if the cigarettes were originally manufactured for export to a foreign country. The Secretary of Revenue is authorized to cancel the license or certificate of registration of a person who violates this law. This change is effective December 1, 1999, and applies to offenses committed on or after that date.

FISCAL IMPACT: The above tobacco export credit and tax exemption for the earnings of the settlement trust fund are expected to reduce General Fund revenues by $8.7 million in fiscal year 1999-2000, $9 million in fiscal year 2000-2001, $9.3 million in fiscal year 2001-2002, $9.6 million in fiscal year 2002-2003, and $9.9 million in fiscal year 2003-2004.

EFFECTIVE DATE: *See Overview section.*

BACKGROUND & ANALYSIS:

History of the Master Settlement Agreement. On November 23, 1998, forty-six states, including North Carolina, and four tobacco manufacturers signed a Master Settlement Agreement, that settled existing and potential claims of the states against the manufacturers for damages arising from the tobacco products of the manufacturers.[4] The manufacturers agreed to make payments to the states totaling $206 billion through the year 2025. Pursuant to the terms of the Master Settlement Agreement, North Carolina and the four tobacco manufacturers entered into a consent decree, filed in Wake County Superior Court on December 21, 1998. State of North Carolina v. Phillip Morris, Incorporated, et al., 98 CVS 14377. This consent decree directed the

[4] The four tobacco manufacturers are Phillip Morris, Inc., R. J. Reynolds Tobacco Company, Brown & Williamson Tobacco Corporation, and Lorillard Tobacco Company.

Attorney General to create a nonprofit corporation for purposes of receipt and distribution of 50% of the funds allocated to North Carolina under the Master Settlement Agreement. The consent decree also required that the creation of the corporation had to be approved by the General Assembly. On March 16, 1999, the General Assembly in Senate Bill 6 (S.L. 1999-2) approved the creation of a nonprofit corporation to distribute 50% of Phase I of the settlement funds allocated to North Carolina. S.L. 1999-2 directs that these funds be used for the public charitable purposes of providing economic impact assistance to economically affected or tobacco-dependent regions of the State. S.L. 1999-2 further states the intent of the General Assembly to allocate the remaining 50% of the Phase I settlement funds as follows:

- 25% to a trust fund to be established by the General Assembly for the benefit of tobacco producers, tobacco allotment holders, and persons engaged in tobacco-related businesses.
- 25% to a trust fund to be established by the General Assembly for the benefit of health.[5]

Under the terms of the Master Settlement Agreement, the four manufacturers also acknowledged the adverse effect that the terms of the Agreement would have on the tobacco grower community. The Agreement contains provisions, such as market restrictions, that are expected to result in a decline in demand for tobacco products. As part of the consideration for settling the claims, the Agreement obligated the manufacturers to address these economic concerns of the tobacco growers and tobacco quota holders.

To meet the obligation, the manufacturers agreed to establish a trust called the National Tobacco Grower Settlement Trust. They agreed to pay up to $5.15 billion over the next twelve years into the Trust, referred to as Phase II settlement funds. Proceeds of the Trust would be allocated directly to tobacco growers and tobacco allotment holders in fourteen grower states, including North Carolina, based on a plan developed by a nonprofit corporation in each state composed of government leaders and public members. The Superior Court of Wake County must approve the trust and the payments made under it.[6]

The trust is designed to be a qualified settlement fund under the Internal Revenue Code. As such, it is taxable as a corporate taxpayer at the tax rate of a trust. The primary benefit of being a qualified settlement fund is that the manufacturers who contribute the principal to the fund may claim a tax deduction on the contributions when they are paid into the fund. If it is determined that the trust does not meet the requirements of a qualified settlement fund, the trust's taxation does not change because contributions to a trust are not included in its gross income. However, the manufacturers would not be able to claim a deduction for their contributions until the money was distributed to the growers and quota holders.

For federal and state tax purposes, the contributions to the trust are tax-exempt. To calculate North Carolina taxable income for both corporations and trusts, one begins with federal taxable income. Since the contributions are not included in income for federal tax purposes, they are not included in income for State tax purposes. However, the interest, investment earnings, and gains of both a qualified settlement fund and a trust are taxable for federal and

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[5] As of August 1999, the General Assembly had not established trust funds for the remaining 50% of the Phase I settlement funds.

[6] A court settlement was signed in Wake County Superior Court on August 20, 1999, approving the settlement of the Phase II funds and the distribution of the payments out of these funds to the fourteen grower states.

State tax purposes. Some states exempt qualified settlement funds from state income tax. Locating the settlement fund in a state that does not tax it can maximize the amount of funds distributed to those who suffer economic loss because of the Master Settlement Agreement. Because of North Carolina's role in producing the economic loss, and the desire to have the settlement fund located in this State, the act exempts the interest, investment earnings, and gains of the settlement fund from State income tax.

Provisions of the act. The act carries out the management and distribution of the Phase II funds as follows:

- Board of Directors/Immunity. It authorizes the Speaker of the House of Representatives to appoint one State Representative and the Senate Pro Tempore to appoint one State Senator to the certification board. This is the board that will determine how the Phase II funds will be distributed to North Carolina tobacco farmers and allotment holders. The other members of the board are the Governor, the Commissioner of Agriculture, the Attorney General, two members of the North Carolina congressional delegation selected by the delegation, and four to seven citizens appointed by the Governor. The act provides for limited immunity from liability for the members of the board while performing their duties on behalf of the board. Immunity is not provided for intentional wrongdoing, willful or wanton misconduct, or motor vehicle accidents. Since the board will be a private board, not a State agency, its members will not be covered by the liability insurance coverage the State obtains for its officers and employees.

- Corporate Income Tax Deduction. It provides for a corporate income tax deduction from federal taxable income on the interest, investment earnings, and gains earned on funds in a qualified settlement fund that meets the following conditions:

    1. The settlors of the fund are two or more manufacturers that signed a settlement agreement with North Carolina to settle existing and potential claims of the State against the manufacturers for damages attributable to a product of the manufacturers.

    2. The purpose of the fund is to address potential adverse economic consequences resulting from a decline in demand of the manufactured product expected to occur because of market restrictions and other provisions in the settlement agreement.

    3. A court of North Carolina approves and retains jurisdiction over the fund.

    4. Certain portions of the distributions from the fund are made in accordance with certifications that meet the criteria in the settlement agreement and are provided by a nonprofit entity, the governing board of which includes State officials

- Income Tax Deductions for Trusts. It provides for an income tax deduction for trusts similar to the above deduction. The provision for a tax deduction is set out in both the corporate and trust income tax statutes in case it is determined that the trust does not meet the requirements of a qualified settlement fund.

- Corporate Income Tax Credit/Cigarette Exportation. It allows a corporate income tax credit for tobacco manufacturers who export cigarettes to foreign countries. The credit is a dollar amount per cigarette exported for those manufacturers who export at least 50% as many cigarettes in the taxable year as they did in calendar year 1998. The dollar amount ranges from forty cents to twenty cents per 1,000 cigarettes exported.

The credit is capped at the lesser of $6 million per year or 50% of the manufacturer's corporate tax liability for any given year. Prior to enactment of the act by the General Assembly in the 1999 Session, the issue was raised as to whether or not this tax credit violates GATT, one of the international trade agreements. The General Assembly staff was of the opinion that the tax credit violates GATT, while counsel for one of the four tobacco manufacturers disagreed. It is clear, however, that any challenge to the credit must come from a foreign government. If a foreign government challenges the credit, then the U.S. Justice Department may sue North Carolina. If the Department wins, then federal statute provides that relief is prospective only and persons who have already used the credit cannot be required to repay it. Private citizens have no cause of action on the issue.

- Unlawful to Sell Certain Cigarettes. It prohibits the sale in North Carolina of a package of cigarettes that meets one or more of the following descriptions:
    1. The package differs from the labeling requirements of federal law.
    2. The package is labeled "For Export Only", "U.S. Tax Exempt", "For Use Outside U.S.", or with similar wording.
    3. The package was altered by adding or deleting the wording described in the above two descriptions.
    4. The package was imported into the United States after January 1, 2000, in violation of federal law.
    5. The package violates federal trademark or copyright laws.

A violation of this law is a Class A1 misdemeanor and an unfair trade practice. A package of cigarettes that violates this law is considered contraband and may be seized by a law enforcement officer. The Secretary of Revenue is authorized to cancel the license or the certificate of registration, whichever is applicable, of a person who violates this law.

1999 REVENUE LAWS TECHNICAL CHANGES

Session Law #	Bill #	Sponsor
S.L. 1999-337	**SB 55**	**Senator Cochrane**

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

OVERVIEW: This act makes numerous technical and clarifying changes to the revenue laws and related statutes as recommended by the Revenue Laws Study Committee.

FISCAL IMPACT: Insignificant impact.

EFFECTIVE DATE: July 22, 1999, unless otherwise provided *(see Background & Analysis section)*.

BACKGROUND & ANALYSIS: The following table provides a section-by-section analysis of the changes:

SECTION	EXPLANATION
1	Corrects an incorrect effective date for the income tax treatment of enhanced wireless 911 fees.
2	Updates list of debtors' property that is retained free of creditors' claims, to add Roth IRAs to regular IRAs and to update terminology for regular IRAs.
3	Reinstates increase in notary commission fee from $25 to $30 that was enacted in the 1998 budget bill but was deleted inadvertently by another 1998 bill. This fee increase became effective October 1, 1999.
4 – 11	Changes references to the inheritance tax, which was replaced with an estate tax effective for the estates of decedents dying on or after January 1, 1999.
12	Corrects a grammatical error by deleting the word "or" in G.S. 93B-15.
13	Deletes language in G.S. 105-32.8 that a person "is subject to the penalties in G.S. 105-236" when that person fails to report a federal correction or determination of the maximum state death tax credit allowed an estate or of the maximum state generation-skipping transfer tax credit allowed. Failure to report to the Secretary of Revenue would still result in forfeiture of the right to any refund due by reason of the determination. Since repeal of the inheritance tax laws, there are no penalties in G.S. 105-236 that apply to this section.
14	Combines G.S. 105-37.1 (Amusements) and G.S. 105-38 (Amusements-Circuses and other traveling amusements) into one statute. These are the amusements subject to 3% gross receipts tax.
15	Moves the language that exempts certain motion pictures from the privilege tax imposed on motion pictures in G.S. 105-38.1 to the list of exemptions in G.S. 104-40 (Amusements exempt from tax).
16	Repeals G.S. 105-109.1 because it is no longer needed. This statute provides that interest will be assessed on the taxes on gross receipts levied on amusements in G.S. 105-37.1 and G.S. 105-38, the tax on installment paper dealers, and the tax on publishers of newsprint publications. This interest runs from the time these taxes were due until paid. This statute is no longer needed now that Article 9 (General Administration; Penalties and Remedies) applies to the privilege license statutes. This repeal also clarifies that interest applies to late payments of the 1% gross receipts tax on movies.
17	Repeals G.S. 105-113 because it is obsolete. This statute requires the sheriff of each county and clerk of the board of alderman of each city to make an annual report to the Secretary of Revenue containing the name and business of every person in the county or city required to obtain a State license under Article 2 of Chapter 105 of the General Statutes.

SECTION	EXPLANATION
18	Clarifies that the possession of more than six hundred cigarettes on which tax has been paid to (was "bearing the tax stamp of") another state or country, by any person other than a licensed distributor, is prima facie evidence that the cigarettes are possessed in violation of this State's tobacco products tax. The underlined language clarifies how the Department currently administers this law. This change is needed because there are states that do not use stamps.
19	Updates the statutory cross-references in the Unauthorized Substance tax law.
20	Clarifies scope of franchise tax to include savings and loan associations, as enacted in 1998.
21	Clarifies that a corporation that owes franchise tax but not income tax must apportion its franchise tax using the apportionment formula that would apply to income tax if the corporation were subject to that tax. The law is silent on this issue, and this new language sets out the Department's position.
22	Removes a reference to G.S. 105-130.17 concerning the form of an affirmation because the subsection in that statute pertaining to the form of the affirmation was repealed in 1998. It provides that the affirmation must be in the form required by the Secretary. It also modernizes statutory language. The reference to G.S. 105-236 is unnecessary because the administrative provisions in G.S. 105-236 automatically apply to the corporate income tax statutes.
23	Restores the word "generator" which was inadvertently deleted in 1998. This statute was later repealed by S.L. 1999-342.
24	Changes "Division" to "Part" to conform to new terms enacted in 1998.
25	Changes the reference to the Code section in G.S. 105-152(e). This statute concerns joint tax liability and the innocent spouse. In the IRS Restructuring Act of 1998, the Code section 6013(e) was deleted and substituted in section 6015.
26	Removes reference to repealed statute.
27	Changes "Division" to "Part" to conform to new terms enacted in 1998.
28	Transfers the definitions of "moped" and "special mobile equipment" from Chapter 20 to the sales tax statute in Chapter 105, and then places a cross-reference to the sales tax statute in Chapter 20. These items are subject to sales tax. The Department of Revenue, rather than the DMV, administers the sales tax on special mobile equipment.
29	Adds the term "card-operated" to the sales tax exemption from receipts derived from coin or token-operated washing machines, extractors, and dryers. New technology permits the use of credit and debit cards on this

SECTION	EXPLANATION
	equipment, and the Department has administratively allowed the sales tax exclusion for equipment operated with cards.
30	Clarifies that the certificate of registration filed with the Department by a retailer who makes taxable sales is void if for a period of 18 months the retailer files no returns or files returns showing no sales. Some retailers make only wholesale sales or exempt sales. Those retailers do not need to file sales tax returns and their certificate should not be void because they fail to file a return for a period of 18 months. There was a similar provision in the law prior to its rewrite last session.
31	Deletes the word "burlap" from the reference to the sales tax exemption for the lease or rental of burlap tobacco sheets used in handling tobacco in the warehouse and transporting tobacco to and from the warehouse. This change is necessary because tobacco sheets are now made of other material.
32	Clarifies the filing requirement for the excise tax on piped natural gas. Payment is required monthly and a return is required quarterly. The Department is currently administering the filing requirement this way.
33	Changes references to the inheritance tax, which was replaced with an estate tax effective for the estates of decedents dying on or after January 1, 1999.
34	Adds reference to limited liability companies to conform to remainder of statute.
35	Revises and recodifies a statute that included redundant references to the taxability of property transferred to a tax-exempt nonprofit corporation.
36	Changes statutory references to conform with the movement of the definitions from Chapter 20 to Chapter 105 made in section 28 of this act.
37-42	Deletes references to the "annual filing" of motor carrier reports. The Department of Revenue does not allow annual filing because of the International Fuel Tax Agreement requirements. The reports must be filed quarterly. They also change the reference to motor fuel from "gasoline and other motor fuel" to "motor fuel and alternative fuel". These references were not changed when tax at the rack was enacted in 1995 and need to be updated. Section 41 also conforms the registration of motor carriers with the current administrative practice.
43-44	Conforms motor fuel penalty-hearing statute to other hearing procedure statutes. Also clarifies that a request for a hearing must explain why the person is not liable for the penalty.
45	Corrects an incorrect statute reference.
46	Savings clause

SECTION	EXPLANATION
47	Effective date

OMNIBUS ESC CHANGES

Session Law #	Bill #	Sponsor
S.L. 1999-340	HB 276	Representative Redwine

AN ACT MAKING VARIOUS CHANGES TO THE EMPLOYMENT SECURITY LAWS OF NORTH CAROLINA.

OVERVIEW: This act contains a number of changes recommended by the Employment Security Commission. It includes the following tax law changes, which became effective July 22, 1999, as well as technical and conforming changes:

- Section 1 authorizes electronic funds transfer and credit card payments for unemployment insurance taxes.
- Section 2 extends the requirement for automated filing of employee information in the "Employer's Quarterly Tax and Wage Report" to employers with 100 or more employees.
- Section 8 authorizes the Department of Revenue to share with the Employment Security Commission additional taxpayer information for use in the NC WORKS study and Section 10 prohibits the Commission from disclosing this information.

FISCAL IMPACT: Insignificant impact.

EFFECTIVE DATE: July 22, 1999.

BACKGROUND & ANALYSIS:

EFT/Credit Card Payments. Before enactment of this act, the employment security law contained no provisions allowing payment of unemployment insurance contributions by electronic funds transfer (EFT) or by credit card. Section 1 of this act authorizes employers to utilize EFT for paying unemployment insurance contributions. The act defines "EFT" as a transfer of funds using an electronic terminal, a telephone, a computer, or magnetic tape to instruct or authorize a financial institution to credit or debit an account. This definition is identical to the definition of EFT that applies in the Revenue Act, as provided in G.S. 105-228.90. Section 1 also authorizes the Employment Security Commission to establish policies to permit employers to pay unemployment insurance contributions by credit card. The policies must require the employer to pay any fee charged to the ESC for use of the card.

Automated Filing of Employee Information. Under prior law, an employer with 250 or more employees, and an agent who reports wages for an employer with 250 or more employees, must file the employee information portion of the quarterly tax and wage report on magnetic tapes or diskettes, as prescribed by the Employment Security Commission. Section 2 of this act extends the electronic filing requirement to employers with 100 or more employees, and to their reporting agents.

Information for Use in NC WORKS Study. G.S. 108A-29(r) requires each county's Job Service Employer Committee or Workforce Development Board to study the working poor in that county and report annually to various oversight committees of the General Assembly. This report is called the NC WORKS report. The tax secrecy law authorizes the Department of Revenue to disclose individual income taxpayer information to the Employment Security Commission in order to assist the county committees and boards with the report. The Employment Security Commission may use the information only in a nonidentifying form for statistical and analytical purposes. The prior law authorized the Department of Revenue to share the following information: name, social security number, spouse's name, county of residence, filing status, federal personal exemptions, federal taxable income and North Carolina additions to it, North Carolina income, and total income. Section 8 of this act expands the type of information that may be shared to include spouse's social security number, exemption for children, nonresidents' and part-year residents' exemption for children, credit for children, and detailed information related to the credit for child care and employment-related expenses. Section 10 of this act clarifies that this information is subject to the same confidentiality law as other tax information obtained by the Employment Security Commission.

USE TAX PAYMENT/OTHER CHANGES

Session Law #	Bill #	Sponsor
S.L. 1999-341	**HB 1433**	**Representative Miller**

AN ACT TO PROVIDE FOR INDIVIDUALS TO PAY THEIR ANNUAL USE TAX WITH THEIR INCOME TAX FORMS, TO PROMOTE ELECTRONIC FILING, AND TO IMPROVE TAX COLLECTION.

OVERVIEW: This act simplifies use tax collection and seeks to improve tax collection in several ways:

- It provides that an individual who owes use tax to the State on non-business purchases can pay the tax with the individual's income tax return.
- It promotes the electronic filing of semimonthly sales tax reports.
- It directs the Secretary of Revenue to contract for the collection of delinquent tax debts owed by nonresidents and foreign entities.
- It directs the Department of Revenue and the State Controller to study the feasibility of a central collection operation.
- It prohibits State agencies from contracting with a vendor who is required under G.S. 105-164.8(b) to collect State sales and use tax but refuses to do so.

FISCAL IMPACT: The act is expected to increase General Fund revenues by $1.67 million in fiscal year 1999-2000, $1.75 million in fiscal year 2000-2001, $1.84 million in fiscal year 2001-2002, $1.93 million in fiscal year 2002-2003, and $2.03 million in fiscal year 2003-2004.

EFFECTIVE DATE: *See Background & Analysis section.*

BACKGROUND & ANALYSIS: North Carolina has a State and Local sales and use tax at the combined rate of 6%. (The combined rate is 6 ½ % in Mecklenburg County.) The sales tax

is paid on purchases made in this State. The tax is collected by the retailer and remitted to the State. The use tax complements the sales tax by taxing transactions that are not subject to the sales tax because of movement in interstate commerce. Like the sales tax, the use tax is imposed on the purchaser. Unlike the sales tax, the responsibility for remitting the use tax to the Department of Revenue is also on the purchaser.

The 1997 General Assembly enacted S.L.1997-77, which established an annual filing period for the payment of use taxes owed by consumers on mail-order and other out-of-state purchases. This change relieved consumers of the need to file either monthly or quarterly returns. *(For additional background information on use taxes, see below.)*

Use Tax Payable on Income Tax Returns. The act further simplifies use tax collection by providing that the use tax will be paid on the taxpayers' income tax returns. An individual who owes use tax on nonbusiness purchases and who must remit a State income tax return must pay the use tax owed with the income tax return. The income tax return will have space on it to indicate the amount of use tax owed. By placing the use tax on the individual income tax return, as opposed to a separate use return sent to the taxpayer with the income tax return, it is hoped that taxpayers' awareness of their responsibility to pay the tax will increase since taxpayers must affirm that the information on the income tax return is true and complete by signing the return. The Secretary of Revenue is required to provide information on the individual income tax form and instructions to explain a person's obligation to pay use tax on items purchased from mail order, Internet, or other sellers that do not collect State sales tax on items. The Secretary must also provide a method to help a person determine the amount of use tax owed. This method must list categories of items that are commonly sold by mail order or Internet and must include a table that gives the average amounts of use tax payable by taxpayers in various income ranges.

This portion of the act is effective for taxable years beginning on or after January 1, 1999.

Use of Use Tax Revenue. The act allows the Department of Revenue to use some of the additional use tax revenue collected under it to promote tax collections as follows:

- The Department may use $150,000 to pay for the costs of programming, form revision, and resources for taxpayer assistance in connection with the new use tax collection method.
- The Department may use $500,000 to implement a program to allow semimonthly sales and use taxpayers to file their returns electronically.
- The Department may use some of the revenue to contract for the collection of delinquent tax debts owed by nonresidents and foreign entities. A delinquent tax debt is the amount of tax due as stated in a final notice of assessment issued to the taxpayer when the taxpayer no longer has the right to contest the debt. The Department must report on its collections pursuant to this contract to the Revenue Laws Study Committee.
- The Department may use up to $50,000 to conduct a study, in cooperation with the State Controller, to identify and evaluate proposals for more efficient collection of taxes. The Department must report is findings, recommendations, and estimated revenue gains to the Revenue Laws Study Committee by May 1, 2000.

State Contracts with Certain Vendors Prohibited. Effective July 1, 1999, the State is prohibited from contracting with a vendor for goods or services if the vendor is required by G.S. 105-164.8(b) to collect use tax for the State but refuses to do so. G.S. 105-164.8 requires

a retailer that is engaged in business in this State to collect use tax on a mail order sale. Subsection (b) of this statute provides that a retailer that makes a mail order sale is engaged in business in this State if the retailer meets one or more of the following conditions:

- Is a corporation engaged in business under the laws of this State.
- Maintains offices in this State.
- Has representatives in this State who solicit business or transact business on behalf of the retailer.
- Is purposefully or systematically exploiting the market in this State by any media-assisted, media-facilitated, or media-solicited means, including direct mail advertising, distribution of catalogs, computer-assisted shopping, etc.
- Resides in a jurisdiction that has a compact or reciprocity with North Carolina to support North Carolina's taxing power.
- Consents to the imposition of the collection of the tax.

Disclosure of Information. Effective July 1, 1999, the act also amends the tax secrecy provisions to allow the Secretary of Revenue to make two disclosures.

1. The Secretary may provide the Secretary of Administration with a list of vendors who refuse to collect the State's use tax even though they are required to do so under G.S. 105-164.8.
2. The Secretary may provide the public with access to a database containing the names and account numbers of taxpayers who are not required to pay sales and use tax because of an exemption or because they are authorized to pay the tax directly to the Department.

Additional Background on Use Tax Collections: In the 1980s, states around the country became increasingly aware of the revenue loss associated with taxpayer avoidance of the use tax. The potential increase in State and local revenue for North Carolina, if full taxpayer compliance were achieved, would exceed $100 million.

The most cost-effective manner to collect the tax, from a state's point-of-view, is to require the out-of-state retailers to collect and remit the use tax. However, in 1967, the U.S. Supreme Court ruled in National Bellas Hess Inc. v. Department of Revenue that a state could not require an out-of-state retailer to collect its use tax unless the retailer has enough contacts with the state to subject it to the state's taxing jurisdiction. The Supreme Court reaffirmed this decision in 1992 in Quill Company v. North Dakota.

States have negotiated with direct marketers on at least two occasions to craft a voluntary collection agreement where marketers would collect the tax and states would simplify their reporting requirements. Both of these efforts were unsuccessful.

There are three efforts currently under way to address the issue of out-of state purchases:

- The National Tax Association Communications and Electronic Commerce Tax Project is focusing on a simplified multi-state approach to sales and use taxation of remote sellers which would require states to adopt common definitions of tax base components and impose a single tax rate statewide.

- The Advisory Commission on Electronic Commerce was established by the Internet Tax Freedom Act. This Act was part of the omnibus federal budget bill signed into law on October 21, 1998. The Advisory Commission has 18 months from this date to study electronic commerce issues and to make a report to Congress.
- The Multistate Tax Commission Tax Simplification Project is comprised of representatives of business and state and local governments who are focusing on ways to simplify the sales and use tax in the areas of uniformity and reporting. The act contains several recommendations made to the Project by the North Carolina representatives. These recommendations are (1) the promotion of electronic filing of semimonthly sales and use tax reports, (2) the authority of the Secretary of Revenue to provide the Secretary of Administration with a list of vendors who refuse to collect the State's use tax even though the vendors are required by law to collect the tax, and (3) the authority of the Secretary of Revenue to provide the public with access to a database containing the names and account numbers of taxpayers who are not required to pay sales and use tax.

SIMPLIFY RENEWABLE ENERGY CREDITS

Session Law #	Bill #	Sponsor
S.L. 1999-342	**HB 1472**	**Representative Hackney**

AN ACT TO SIMPLIFY AND MODERNIZE TAX CREDITS FOR INVESTING IN RENEWABLE ENERGY SOURCES.

OVERVIEW: This act repeals nine corporate and individual income tax credits relating to energy savings devices and replaces them with a tax credit for investing in renewable energy property.

FISCAL IMPACT: The effect of this act on General Fund revenues cannot be estimated.

EFFECTIVE DATE: The act becomes effective beginning with the 2000 taxable year.

BACKGROUND & ANALYSIS: The General Assembly enacted several individual and corporate income tax credits in the 1980s to encourage the following energy saving investments:

- Solar energy equipment.
- Conversion of industrial boilers to wood fuel.
- Peat facility.
- Olivine brick facility.
- Methane gas facility.
- Wind energy device.
- Hydroelectric generator.

Of these credits, there is no evidence that the ones for peat, wind energy, olivine bricks, and methane have ever been used. This act repeals nine income tax credits for these types of property and substitutes a general credit for investing in renewable energy property. The new credit applies to a broader category of property and is, generally, more generous than the prior law credits. The intent of the act is that the broader category of renewable energy

property will reflect technological advances in renewable energy and that the more generous credit percentages, caps, and carryforwards will encourage more investment in renewable energy property.

The credit percentage for the prior law credits ranged from 10% to 40% of the taxpayer's investment; the new credit percentage is 35% of the investment. Most of the prior law credits were capped at between $1,000 and $25,000 per installation. The renewable energy credit is capped at between $1,400 and $10,500 for residential installations and at $250,000 per installation for nonresidential installations (although the credit must be taken in five annual installments unless it is for a single family dwelling installation). The prior law credits were allowed against income tax only; the renewable energy credit is allowed against either income or franchise tax, but may not exceed 50% of the taxpayer's tax liability for a taxable year. Only about half of the prior law credits allowed carryforwards; the renewable energy credit may be carried forward for five years.

The act defines renewable energy property as any of the following machinery and equipment or real property:

- Biomass equipment that uses renewable biomass resources for biofuel production of ethanol, methanol, and biodiesel. Renewable biomass resources are organic matters produced by terrestrial and aquatic plants and animals, such as standing vegetation, forestry and agricultural residues, landfill wastes, and animal wastes.
- Hydroelectric generators.
- Solar energy equipment.
- Wind equipment.

The amount of the credit is 35% of the cost of the property placed in service. In the case of renewable energy property that serves a single-family dwelling, the credit must be taken for the taxable year in which the property is placed in service. For all other renewable energy property, the credit must be taken in five equal installments, beginning with the taxable year in which the property is placed in service. The credit may not exceed the following amounts:

TYPE OF PROPERTY	***MAXIMUM CREDIT***
Nonresidential Property	$250,000 per installation
Residential Property – Solar energy equipment for domestic water heating	$1,400 per dwelling unit
Residential Property – Solar energy equipment for active space heating, combined active space and domestic hot water systems, and passive space heating	$3,500 per dwelling unit
Residential Property – All other renewable energy property for residential purposes	$10,500 per installation

The credit is patterned after the business tax credit and is codified in the same Article. Like the business tax credit, the renewable energy tax credit has the following limitations and conditions:

- The renewable energy tax credit may not exceed 50% of the tax against which it is claimed for the taxable year. Any unused portion of the credit may be carried forward

for the succeeding five years.

- A taxpayer that claims any other credit allowed with respect to renewable energy property may not take the renewable energy tax credit with respect to the same property.
- A taxpayer may not take the renewable energy tax credit if the taxpayer leases the property from another person, unless the taxpayer obtains the lessor's written certification that the lessor will not claim a credit with respect to this property.
- The Department of Revenue must report each year on the number of taxpayers claiming the credits, the cost of the property for which the credits were claimed, and the total cost to the General Fund of the credits claimed.
- The business tax credit is repealed effective January 1, 2002, while the remainder of the Article is repealed effective January 1, 2006. Consequently, the renewable energy tax credit is set to sunset on January 1, 2006.

Prior Credits Repealed. The following chart lists the prior law credits repealed by this act:

G.S.	*SHORT TITLE*	%	*CEILING*	*CARRY-FORWARD*
105-130.23.	Credit against corporate income tax for solar energy equipment in residential buildings.	40%	$1,500 per unit	Five years
105-151.2.	Credit for solar energy equipment.	40%	$1,500 per unit	Five years
105-130.26 & 105-151.5.	Credit for conversion of industrial boiler to wood fuel.	15%	None	Five years
105-130.27A.	Credit for construction of a peat facility.	20%	None	Five years
105-130.29.	Credit for construction of an olivine brick facility.	20%	None	Five years
105-130.30 & 105-151.10.	Credit for construction of a methane gas facility.	10%	$2,500 per installation	None
105-130.31 & 105-151.9.	Credit for installation of a wind energy device.	10%	$1,000 per installation	None
105-130.32 & 105-151.8.	Credit for installation of solar energy equipment for the production of heat or electricity in certain processes.	35%	$25,000 per installation	None
105-130.33 & 105-151.7.	Credit against corporate income tax for installation of a hydroelectric generator.	10%	$5,000 per installation	None

NEWSPRINT TAX CREDIT CHANGE

Session Law #	Bill #	Sponsor
S.L. 1999-346	**HB 1479**	**Representative Miller**

AN ACT TO AMEND THE NEWSPRINT RECYCLING TAX.

OVERVIEW: **This act modifies the excise tax on virgin newsprint by postponing the increase in the percentage of recycled content required and by expanding the credit for recycling.**

FISCAL IMPACT: The act is expected to reduce revenues in the Solid Waste Management Trust Fund by less than $1,000 per year.

EFFECTIVE DATE: July 1, 1999

BACKGROUND & ANALYSIS: A publisher must pay a privilege license tax of $15 for each ton of newsprint it consumes that does not have a minimum recycled content. The General Assembly enacted this excise tax on newsprint in 1991 to encourage the use of recycled newsprint. The minimum amount of recycled paper required has been phased up since 1991 from 12% to 35% and was set to increase to 40% in 2001. This act delays this increase in the minimum recycled content percentage until 2005.

There is a credit that can be used towards the recycled content percentage goals for publishers who develop and operate, or contract for the operation of, a newspaper recycling program. Under prior law, a publisher could receive one-half ton credit toward its total recycled content tonnage for each ton of newsprint it recycled. This act increases the credit from one-half ton to one ton, and expands it to include recycling of magazines as well as newsprint.

The proceeds of the tax are earmarked for the Solid Waste Management Trust Fund[7]. The tax generates less than $2,000 a year in revenue. The tax does not apply if the producer cannot meet the recycled content goal because of an inability to obtain newsprint made from recycled paper at a price or quality comparable to other newsprint, to acquire an amount needed for a publication, or to acquire the amount needed in a reasonable amount of time.

MOTOR VEHICLE TAX VALUE/E&R BOARD

Session Law #	Bill #	Sponsor
S.L. 1999-353	**HB 315**	**Representative C. Wilson**

AN ACT TO PROVIDE THAT A MOTOR VEHICLE'S PROPERTY TAX VALUE IS DETERMINED AS OF JANUARY 1 PRECEDING THE DUE DATE OF THE TAX AND TO AUTHORIZE THE STOKES BOARD OF EQUALIZATION AND REVIEW TO MEET AFTER ITS FORMAL ADJOURNMENT.

[7] The money in this Fund is used to fund activities of the Department of Environment and Natural Resources (DENR) to promote waste reduction and recycling, to fund research on the solid waste stream in North Carolina, to fund activities related to the development of secondary materials markets, to fund demonstration projects, and to fund research by in-State colleges and universities.

OVERVIEW: **This act provides that a classified motor vehicle's property tax value is to be determined on January 1 of the year the taxes are due, effective for taxes imposed for taxable years beginning on or after July 1, 2000. The act also extends the authority of the Stokes County Board of Equalization and Review to meet after its adjournment upon completion of its duties to examine and review the county's tax list for the current year and to hear a request from a taxpayer regarding the taxpayer's property appraisal or listing.**

FISCAL IMPACT:

- Motor vehicle tax value change: This change does not affect General Fund revenues but is expected to reduce local government revenues by $27.6 million in fiscal year 2000-2001, $29.5 million in fiscal year 2001-2002, $31.6 million in fiscal year 2002-2003, and $33.8 million in fiscal year 2003-2004.
- Stokes Co. E&R Bd. Change: No fiscal impact.

EFFECTIVE DATE:

- Motor Vehicle Tax Value Change: Effective for taxes imposed on taxable years beginning on or after July 1, 2000.
- Stokes County E&R Bd. Change: July 22, 1999.

BACKGROUND & ANALYSIS:

Motor Vehicle Property Tax Change. The act changes the date for the determination of the property tax value of a classified motor vehicle from January 1 preceding the date the new registration is applied for or the current registration expires to January 1 of the year the taxes are due. Under the current system, classified vehicles are taxed on a revolving, year-round schedule. Every month, the Division of Motor Vehicles (DMV) provides each county a list of the motor vehicles in the county for which registration was renewed or obtained two months earlier. The county lists and appraises the vehicles and sends each vehicle owner a bill for the county, city, and special district taxes due. If the owner does not pay the taxes due on a classified, registered vehicle, DMV will refuse to renew the vehicle registration the following year unless the owner obtains a receipt showing that the taxes have been paid.

For classified motor vehicles, the ownership, situs, and taxability of the vehicle are determined annually as of the day on which a new registration is applied for or the day on which the current vehicle registration is renewed. However, the value of the vehicle is determined annually as of January 1 preceding the date the new registration is applied for or the current registration expires. Therefore, property tax bills that taxpayers receive in January through April of each year are based on the value of the vehicles as of January of the preceding year. This means that the property tax assessment can reflect values as old as 16 months. By moving the property tax valuation date to January 1 of the year the taxes are due, the act ties the value of the vehicle closer to its true value in money. The taxes become due on the first day of the fourth month after the registration is applied for (or the previous registration expired). Thus if the registration is applied for in September or later, the valuation date is the following January. If the registration is applied for before September, the valuation date is the preceding January.

The value of a vehicle, like all other tangible personal property, is based upon its true value in money as prescribed by G.S. 105-283.

Stokes County Equalization and Review Board Change. The second part of the act authorizes the Stokes County Board of Equalization and Review to continue meeting after the

Board has performed its statutory duties of examining and reviewing the tax lists for the current year and of hearing any request of a taxpayer with respect to the listing or appraisal of property. G.S. 105-322(e) requires a board of equalization and review to complete the above duties by a specified date. The act amended this statute, effective July 22, 1999, to allow the Stokes County Board of Equalization and Review to continue to meet upon completion of these statutory duties in order to carry out the following duties:

- To hear and decide all appeals relating to discovered property.
- To hear and decide all appeals relating to the appraisal, situs, and taxability of classified motor vehicles.
- To hear and decide all appeals relating to audits of property classified at present-use value and to audits of property exempted or excluded from taxation.

AMEND BILL LEE ACT/INCENTIVES

Session Law #	Bill #	Sponsor
S.L. 1999-360	**SB 1115**	**Senator Kerr**

AN ACT TO PROVIDE FOR WIDELY SHARED PROSPERITY BY AMENDING THE WILLIAM S. LEE QUALITY JOBS AND BUSINESS EXPANSION ACT, BY PROVIDING ADDITIONAL TAX INCENTIVES FOR VARIOUS BUSINESSES, AND BY MAKING RELATED CHANGES.

OVERVIEW: This act amends the tax laws to expand existing tax incentives for businesses, add new tax incentives and tax reductions for specific businesses, and make related changes. The provisions of the act are listed below, followed by a detailed summary of each provision.	***EFFECTIVE DATE***	***FISCAL IMPACT***
Extend Sunsets on Bill Lee Act Credits.		
Extend sunset on Bill Lee Act from 2002 to 2006, and require Department of Commerce to continue studying impact of Bill Lee Act incentives.	8/4/99	The extension of the sunset will result in a loss of revenue to the General Fund of approximately $13.1 million in the 2002-2003 fiscal year; the loss is expected to increase to as much as $38.1 million by fiscal year 2005-2006.
Incentives for Interstate Passenger Air Carrier Hubs.		
Add passenger air carrier training centers to Bill Lee Act credits.	1/1/99	This change will have an insignificant impact on General Fund revenues.

Allow an interstate passenger air carrier a sales tax exemption for aircraft parts and accessories purchased for use at its hub in this State.	5/1/99	This change will reduce General Fund revenues by approximately $1.2 million a year. It will also reduce local sales tax revenues.
Reduce sales tax from 6% to 1% with an $80 cap for flight crew training aircraft simulators purchased by an interstate passenger air carrier for use at its hub in this State.	5/1/99	This change will reduce General Fund revenues by approximately $400,000 a year. It will also reduce local sales tax revenues.
Incentives for Non-Profit Insurance Companies.		
Allow certain nonprofit insurance companies an eight-year sales tax refund for taxes paid on building materials and fixtures, and a four-year sales tax refund for taxes paid on capitalized computer equipment.	5/1/99	These changes will reduce General Fund revenues by approximately $600,000 in fiscal year 2000-2001, $1.2 million in fiscal years 2001-2002 and 2002-2003, and by approximately $100,000 in fiscal year 2003-2004.
Incentives for Tiers One and Two.		
Extend Bill Lee Act credits to electronic mail order houses that create at least 250 jobs in tiers one and two.	1/1/00	This change will reduce General Fund revenues by approximately $2.7 million beginning in fiscal year 2001-2002; the loss in revenues is expected to grow to $5.8 million in fiscal year 2004-2005 and decline slightly in fiscal year 2005-2006 to approximately $4.4 million.
Extend Bill Lee Act credits to customer service centers in tiers one and two.	1/1/00	This change will reduce General Fund revenues by approximately $600,000 a year in fiscal year 2001-2002; the loss in revenues is expected to grow to an annual loss of $2.4 million by fiscal year 2005-2006.

Allow annual refund of 6% sales taxes paid on capitalized machinery and equipment sold to businesses eligible for Bill Lee Act credits and located in tiers one and two.	1/1/00	This change will reduce General Fund revenues by approximately $100,000 a year beginning in fiscal year 2000-2001. The annual loss is expected to increase to $1 million by fiscal year 2005-2006.
Incentives for Small Counties.		
Give a more favorable tier designation to small counties.	1/1/00	This change is expected to have an insignificant impact on General Fund revenues.
Close Development Zone Loopholes.		
Close loopholes in definition of development zones.	8/1/99	This change is expected to increase General Fund revenues by $100,000 a year in fiscal years 2000-2001 and 2001-2002, by $600,000 a year in fiscal year 2002-2003, and by $300,000 a year in fiscal year 2003-2004.
Credit for Development Zone Projects.		
Allow a 25% credit for contributions to nonprofits for capital projects within development zones.	1/1/00	This change is expected to reduce General Fund revenues by $2.5 million in fiscal year 2001-2002 and by $4 million for each year thereafter.
Affordable Housing Tax Credit.		
Allow a credit for rehabilitating or constructing affordable housing, effective for new projects.	Beginning: 1/1/00 Sunset: 1/1/06	This change is expected to reduce General Fund revenues by $1.5 million a year in fiscal year 2001-2002, and by as much as $10.1 million a year by fiscal year 2005-2006.

Extend Bill Lee Act Credits to Insurance Company Administrative Offices.		
Allow all Bill Lee Act credits to be taken against insurance premiums tax.	1/1/99	This change is not expected to significantly affect General Fund revenues.
Quality Jobs Assurance.		
Require businesses to provide health insurance and meet environmental, safety, and health standards in order to qualify for Bill Lee Act credits.	1/1/00	This change is not expected to significantly affect General Fund revenues.
Application Fee and Information Changes.		
Eliminate the $75 application fee for Bill Lee Act credits in tiers one and two and increase the fee to $500 per credit in other tiers, with a cap of $1,500 per applicant.	9/4/99	This change is not expected to significantly affect General Fund revenues.
Require applicants for Bill Lee Act credits to provide additional information to enable Commerce to evaluate the effectiveness of the credits in providing employment to residents of development zones.	9/4/99	N/A
Require taxpayers to include with their tax returns the information that they must generate under current law to establish eligibility for the Bill Lee Act credits.	1/1/00	N/A
Clarify Business Definitions and Refunds.		
Clarify definitions of industries covered by Bill Lee Act, effective immediately	8/4/99	N/A
Clarify sales tax refunds for sales of fuel to interstate air carriers.	10/1/99	N/A
Research and Development Credit.		
Provide that research and development credit will not expire when the corresponding federal credit expires.	1/1/99	This change is not expected to significantly affect General Fund revenues.
Industrial Development Fund/Environmental Certification.		
Require projects to obtain an environmental certification in order to	8/4/99	N/A

qualify for funding from the Industrial Development Fund (Building Renovation Fund), effective when the act becomes law.		
Dept. of Commerce to Oversee Interstate Cooperative Efforts.		
Require the Department of Commerce to support reasonable efforts to reduce interstate competition in luring businesses from one state to another.	8/4/99	N/A
Brownfields Property Fee Changes.		
Increase fees paid to the Department of Environment, Health, and Natural Resources for brownfields agreements applied for after the act becomes law.	8/4/99	This change is not expected to significantly affect General Fund revenues.

FISCAL IMPACT: *See chart above.*

EFFECTIVE DATE: *See chart above.*

BACKGROUND & ANALYSIS:

Extend Sunset on Bill Lee Act Credits. The William S. Lee Quality Jobs and Business Expansion Act was enacted in 1996, effective beginning with the 1996 tax year, with a sunset effective in 2002. The Act required the Department of Commerce to report annually on the credits allowed by the Act. In 1997, the General Assembly added specific issues that the Department of Commerce was required to study and report back on in 1999. Before 1996, North Carolina had made little use of tax incentives to lure businesses to the State. Even without incentives, North Carolina was consistently one of the top states in attracting industry. The array of credits authorized by the William S. Lee Act was viewed as an experiment, to be evaluated in five years to determine whether the incentives were cost effective and actually affected behavior, or merely provided tax reductions to businesses that would have located or expanded in any case. This act extends the 2002 sunset for an additional four years, to 2006, and it renews the requirement that the Department of Commerce study the effect and effectiveness of the Bill Lee Act incentives and report the results of its study to the 2001 General Assembly.

Incentives for Interstate Passenger Air Carrier Hubs. The act provides three incentives for interstate passenger air carriers with hubs in this State. A hub is defined as the airport where the carrier has allocated at least 60% of its aircraft property tax value and at which the majority of its boarding passengers are connecting from other airports, not originating at that airport. U.S. Airways, whose hub is in Charlotte, qualifies for the credit. Midway Airlines, whose hub is at Raleigh-Durham, should qualify for the credit by the end of 1999.

The first incentive for passenger air carriers is to provide that the Bill Lee Act definition of central administrative offices includes centralized training offices at an air carrier's hub, effective beginning with the 1999 tax year. This change allows the air carrier to qualify for the central administrative office credit, described below, as well as for the existing Bill Lee Act credit for creating jobs, credit for investing in machinery and equipment, credit for research and development, and credit for worker training. These credits can be taken with respect to the training center only.

The central administrative office credit is allowed to taxpayers that purchase or lease real property to be used as central administrative office property with 40 or more employees. The amount of the credit is equal to 7% of the eligible investment amount and may not exceed $500,000. The credit is taken in seven equal installments over the seven years following the taxable year in which the property is first used as a central administrative office.

The second incentive for passenger air carriers is a sales tax exemption for the carrier's purchases of aircraft lubricants, parts, and accessories for use at its hub, effective beginning May 1, 1999. These purchases would otherwise be subject to sales tax at 6%, but interstate air carriers are allowed a partial refund of the tax under G.S. 105-164.14(a). In 1998, the General Assembly enacted a similar exemption for air couriers (Federal Express), effective January 1, 2001.

The third incentive for passenger air carriers is a sales tax reduction from 6% to 1% with an $80 cap, for purchases of aircraft simulators for flight crew training for use at the hub, effective beginning May 1, 1999. The tax reduction would also apply to interstate air couriers. U.S. Airways plans to establish a flight crew training center at its Charlotte hub, where it would use aircraft simulators.

Incentive for Nonprofit Insurance Companies. The act provides a sales tax refund to certain nonprofit insurance companies for State and local taxes they pay on building materials, supplies, fixtures, and equipment that become a part of their real property and on capitalized computer systems hardware and software. The refund is effective beginning with taxes paid on May 1, 1999. The computer equipment refund expires for taxes paid on or after January 1, 2004, and the building materials refund expires for taxes paid on or after January 1, 2008. To qualify for these refunds, the insurance company must be operated for the exclusive purpose of providing insurance products to nonprofit charitable organizations and their employees. In addition, the Secretary of Commerce must have certified that the insurance company will invest at least $20 million in this State. TIAA, which has announced plans to build an office in Mecklenburg County, fits this description.[8] If TIAA fails to make the $20 million investment within five years after it first receives a refund, it forfeits all refunds it received as a result of this incentive.

Incentives for Enterprise Tiers One and Two. The act provides three incentives for development in enterprise tier one and two counties, which are the counties considered most in need of economic development based on high unemployment, low per capita income, and low population growth.[9] The first incentive extends all of the Bill Lee Act credits to electronic mail order houses that create at least 250 jobs located in an enterprise tier one or two county. The second incentive extends all of the Bill Lee Act credits to certain customer service centers located in an enterprise tier one or two county. An eligible customer service center is a subdivision of a telecommunications or financial services company that provides support services to the company's customers by telephone to support the company's products and services. To qualify, at least 60% of the center's calls must be incoming. This requirement will prevent telemarketing operations from qualifying. The credits allowed under the Bill Lee Act, which this act extends to these electronic mail order houses and customer service centers effective January 1, 2000, are

[8] There may be one or more other nonprofit insurance companies that could qualify, but only if they make a $20 million investment.

[9] The following 13 counties are in tier one for 1999: Bertie, Edgecombe, Graham, Halifax, Hertford, Hyde, Martin, Northampton, Richmond, Swain, Tyrrell, Warren, and Washington. The following 15 counties are in tier two for 1999: Alleghany, Anson, Ashe, Beaufort, Cherokee, Columbus, Mitchell, Montgomery, Onslow, Perquimans, Robeson, Rutherford, Scotland, Vance, and Yancey.

the credit for creating jobs, the credit for investing in machinery and equipment, the credit for research and development, the credit for worker training, and the credit for investing in central administrative office property.

The third incentive allows an annual sales tax refund on taxes paid at 6% (6.5% in Mecklenburg County) on capitalized machinery and equipment sold to a taxpayer engaged in one of the businesses eligible for Bill Lee Act credits, for use in an enterprise tier one or two county. This provision will become effective for taxes paid on or after January 1, 2000. In addition to tier one and two customer service centers and electronic mail order houses discussed above, the following businesses are eligible for Bill Lee Act credits: air courier services, central administrative offices (with at least 40 new jobs), data processing, manufacturing, warehousing, and wholesale trade.

Incentives for Small Counties. The act allows certain counties to qualify for a lower enterprise tier designation, effective January 1, 2000. Under the Bill Lee Act, all counties are divided into five enterprise tiers, ranked by economic distress as measured by a formula that combines unemployment, per capita income, and population growth. Those counties in lower-numbered tiers receive more favorable incentives than those in higher tiers.

First, this act changes the rules for assigning enterprise tier designations to provide that the tier number that would otherwise be assigned by the formula is reduced by one for counties that have a population of less than 50,000 and also have more than 18% of their residents below the federal poverty level. Under this provision, Alleghany, Ashe, Beaufort, Cherokee, Perquimans, Scotland, Vance, and Yancey Counties would move from tier two to tier one; Bladen, Hoke, Jones, Madison, Pamlico, and Pasquotank Counties would move from tier three to tier two; and Duplin, Greene, and Watauga Counties would move from tier four to tier three. Second, the act provides that a county that has a population of less than 25,000 cannot be designated higher than tier three. Under this provision, Polk and Currituck Counties would move from tier five to tier three. Third, the act provides that a county is designated as tier one if it has a population of less than 10,000 and also has more than 16% of its residents below the federal poverty level. Under this provision, Camden, Clay, and Jones Counties would become tier one counties.

Close Development Zone Loopholes. In 1998, the General Assembly amended the Bill Lee Act to provide additional incentives for businesses that locate or expand in development zones, which are economically distressed areas located within cities. The statutory conditions for qualifying as a development zone were designed to target only these relatively small, economically distressed areas. The statutory conditions contained loopholes, however, that allowed large areas outside of cities to qualify, even if they were not economically distressed throughout. The act closes those loopholes, effective for development zone designations made on or after January 1, 2000.

The 1998 legislation defined a development zone as an area that meets all of the following conditions: (1) consists of one or more contiguous census tracts, block groups, or both, (2) has a population of 1,000 or more, at least 20% of whom are below the poverty level, and (3) is located at least partly in a city with a population over 5,000. This act closes the loopholes in this definition by requiring that:

- Every census tract and census block group in the zone must be located in whole or in part within the primary corporate limits of the city.

- Every census tract and census block group in the zone must have more than 10% of its population below the poverty level, or must be immediately adjacent to a tract or group that has more than 20% of its population below the poverty level.
- None of the census tracts or census block groups may be located in another development zone.

The act also shortens the period during which designation as a development zone is effective, from four years to two years, and requires zone applicants to notify every city in which part of the proposed zone would be located.

The following enhanced incentives apply in development zones: If a business locates in a development zone, the wage standard it has to meet is the same as for tier one counties -- slightly lower than the standard for other counties. In addition, if a business locates in a development zone, its maximum worker training credit is $1,000 rather than $500, it receives an additional $4,000 per job on its jobs tax credit, and there is no threshold for the credit for investing in machinery and equipment.

Credit for Development Zone Projects. The act creates a new tax credit for taxpayers that contribute cash or property to certain nonprofit agencies to be used for an improvement project in a development zone. An improvement project is a project to construct or improve real property for community development purposes or to acquire real property and convert it for community development purposes. The new credit becomes effective beginning with the 2000 tax year.

The credit allowed is 25% of the amount contributed by the taxpayer. The total amount of credits that may be allowed in a taxable year is capped at $4 million. Taxpayers are required to apply to the Secretary of Revenue for these credits. If the total amount applied for in a year exceeds $4 million, the Secretary will reduce each applicant's credit proportionally.

The credit is allowed for contributions to a development zone agency, defined as a community action agency, a community-based development organization, a community development corporation, a community development financial institution, a community housing development organization, or a local housing authority. To qualify for the credit, all of the following conditions must be met:

- The agency must contract in writing to use the contribution for an improvement project in a development zone and to repay the taxpayer with interest if the contribution is not so used.
- The Department of Commerce must certify that the agency will undertake an improvement project in a development zone.[10] To support this certification, the agency must provide the Department documentation establishing the identity of the agency, the nature of the project, and that the project is for a community development purpose in a development zone.
- The taxpayer must be unrelated to the agency and must not control, be controlled by, or be under common control with the agency.

[10] The Secretary of Commerce may not certify a development zone agency if it, any of its officers or directors, or any partner of the agency has ever used part of an improvement project contribution for any purpose other than the improvement project.

- The taxpayer must not receive anything of value for the contribution.

A taxpayer forfeits the tax credit for a contribution to the extent the development zone agency uses the contribution for anything other than an improvement project in a zone. Development zone agencies are required to file with the Department of Commerce annual, audited financial statements. If the Department of Commerce finds that any part of a contribution was used for a purpose other than an improvement project, it must notify the Department of Revenue of the resulting forfeiture.

Affordable Housing Tax Credit. The act creates a new tax credit for rehabilitating or constructing low-income housing, effective for buildings allocated federal credits on or after January 1, 2000. The credit expires for buildings allocated federal credits on or after January 1, 2006. The credit is equal to a percentage of the amount of the taxpayer's federal credit for low-income housing with respect to eligible North Carolina low-income housing. The credit is 75% for buildings located in tier one or two and 25% for buildings located in other tiers. North Carolina low-income housing is eligible if it meets one of the following conditions:

- It is located in a tier one or two enterprise area.
- It is located in a tier three or four enterprise area and has at least 40% of its residential units that are rent-restricted and are occupied by individuals whose income is 50% or less of area median gross income.
- It is located in a tier five enterprise area and has at least 40% of its residential units that are rent-restricted and are occupied by individuals whose income is 35% or less of area median gross income.

The credit is not taken in one year but is spread out over five years beginning when the federal credit is first claimed for the building. The federal credit is first claimed either when the building is placed in service, or the next year, at the taxpayer's election. The federal credit is taken over eleven years.

The federal credit requires that either (1) at least 20% of the residential units are rent-restricted and occupied by individuals whose income is 50% or less of area median gross income or (2) at least 40% of the residential units are rent-restricted and occupied by individuals whose income is 60% or less of area gross income. By providing a higher credit for tier one and two projects and by limiting the State credit to projects that are either in tier one or two or serve lower-income residents, the act is designed to steer investments toward these projects.

The federal credit requires that the low-income housing be used for that purpose for at least 30 years. If this requirement is not met, all or part of the taxpayer's credit is recaptured. Under the State credit, if federal recapture is required, the taxpayer forfeits the North Carolina credit to the same extent. In addition, if the taxpayer no longer qualifies for the federal credit during one of the five years a State installment could otherwise be claimed, the taxpayer is no longer eligible for the State credit. This situation could occur if the taxpayer sold its interest in the low-income housing.

Under federal law, a limited amount of credit is allowed to each state each year, and these credits are allocated among applicants based on selection criteria designed to reward projects that will serve the lowest income tenants for the longest periods. At least 10% of the credits each year must be set aside for projects sponsored by nonprofits. The amount of federal credit allocated to North Carolina will be $9.2 million for the 2000 through 2002 tax years and is expected to increase to $13 million for the 2003 and 2004 tax years. By limiting the State

credit to a percentage of the federal credit, the act automatically caps the potential revenue loss to the State.

Extend Bill Lee Act Credits to Insurance Company Administrative Offices. The act allows all the Bill Lee Act credits to be taken against gross premiums tax, effective beginning in the 1999 tax year. Currently, only the real property credit for central administrative offices may be taken against gross premiums tax.

In 1997, the General Assembly extended the Bill Lee Act credits to central administrative offices that created at least 40 new jobs and created a new tax credit for taxpayers that purchase or lease real property to be used as central administrative office property. In 1998, the General Assembly allowed the real property credit for central administrative offices to be taken against the gross premiums tax as well as against the income tax and the corporate franchise tax. Insurance companies pay gross premiums tax in lieu of income tax. The 1998 legislation did not change the rule that the other Bill Lee Act credits could be taken against only income tax and corporate franchise tax. The 1998 change created a situation in which insurance companies were treated differently from other businesses with respect to central administrative offices. A business, other than an insurance company, that builds a central administrative office can take against income tax not only the real property credit for that office, but also the jobs credit, the investment tax credit, and the worker training credit. An insurance company can take against gross premiums tax only the real property credit, but not the jobs credit, the investment tax credit, or the worker training credit. By extending the other Bill Lee Act credits to gross premiums tax, the act provides uniform treatment for insurance companies and other businesses that build central administrative offices.

Quality Jobs Assurance. The purpose of the original William S. Lee Act was to provide incentives for "high quality jobs." Accordingly, only certain industries qualify for the Bill Lee Act credits and a taxpayer must meet a wage standard with respect to the jobs at the locations for which it claims a credit. This act adds three additional standards to assure that credits are allowed only with respect to high quality jobs. These standards become effective for new credits beginning January 1, 2000. First, the taxpayer must pay at least 50% of basic health insurance coverage for the full-time positions for which it takes a credit. Second, the taxpayer must certify that the business location with respect to which it claims a credit has not had a significant environmental violation in the last five years and has no pending enforcement actions for significant environmental violations. Third, the taxpayer must certify that the business location with respect to which it claims a credit has no outstanding or unresolved OSHA citations and has had no serious violation within the last three years. The Department of Environment and Natural Resources and the Department of Labor are authorized to audit the environmental and OSHA certifications, respectively, and report to the Department of Revenue if they determine that a certification was inaccurate.

Application, Fee, and Information Changes. A taxpayer that wishes to claim a Bill Lee Act credit must apply to the Department of Commerce for certification that it meets the eligibility requirements for the credit. The application must include information to enable the Department of Commerce to determine the applicant's eligibility, and be accompanied by a $75 fee to defray part of the costs of administering the program. This act requires applicants to include information necessary to enable the Department of Commerce to provide data required in its periodic reports to the General Assembly. This data will assist the General Assembly in evaluating the cost effectiveness of the Bill Lee Act credits.

The act also eliminates the $75 fee for credits claimed with respect to enterprise tier one and two counties. For other credits, the fee is increased to $500 per credit claimed, not to exceed

$1,500 per taxpayer. The Department of Commerce will retain ¼ of the fee proceeds for the costs of administering the program, and remit the remaining proceeds to the Department of Revenue for its use in administering and auditing the Bill Lee Act credits. These changes became effective September 4, 1999.

The Bill Lee Act incentives recommended by the Department of Commerce over the last four years have contained many conditions and standards a taxpayer must meet in order to be eligible for the incentives. The incentives also contain what are known as "clawback" provisions, which require a taxpayer to forfeit a targeted incentive if it turns out the taxpayer did not meet the conditions for qualifying for the incentive, and to lose future installments of a tax credit if the job or investment on which the credit was based does not remain in place. This act requires taxpayers that claim Bill Lee Act credits to include with their tax returns information about whether the jobs and investments have remained in place and whether other conditions have been met. The act allows the Department of Revenue to share this information with the Employment Security Commission and the Department of Commerce; this sharing should enable the Department of Commerce to evaluate whether the incentives are accomplishing their purpose of creating high-quality jobs throughout the State.

Clarify Business Definitions and Refunds. The act clarifies the statutory definitions of the types of businesses that are eligible for the Bill Lee Act credits. In 1998, the General Assembly changed the statutory references from the Standard Industrial Classifications (SIC) to the North American Industrial Classification System (NAICS) to conform to the federal system adopted effective January 1, 1999. This system is used to classify most of the data available about industries or kinds of business in the economy. Upon review of the NAICS system, it was discovered that further terminology changes were needed to the Bill Lee Act definitions to assure that the credits would be available to the types of businesses covered by the prior law's definitions.

The act clarifies that interstate air carriers are allowed a partial refund of sales taxes paid on fuel, effective October 1, 1999. This clarification will not change the way the law is currently administered.

Research and Development Credit. The act modifies the research and development credit so that it will not automatically expire if the corresponding federal credit expires. The credit for research and development is allowed only to taxpayers that claim one of the federal research and development credits. In past years, the federal credit has expired and then been renewed retroactively, creating uncertainty for taxpayers. This act amends the State credit so that it is based on the federal credit as of January 1, 1999. Expiration of the federal credit will not affect the State credit. If the federal credit is later modified, the General Assembly can consider whether to update its cross-reference to adopt the federal modifications.

Industrial Development Fund Environmental Certification. The act requires, as a condition for funding from the Industrial Development Fund (Building Renovation Fund), that a project receives certification from the Department of Environment and Natural Resources that it will not have a significant adverse effect on the environment. This change became effective when the act became law, August 4, 1999.

Commerce to Pursue Interstate Cooperative Efforts. The act requires the Department of Commerce to encourage reasonable interstate agreements and federal legislation to control the use of excessive incentives in interstate competition in luring businesses from one state to another. The Department is to report on these efforts by March 1, 2000, and March 1, 2001.

Brownfields Property Fee Changes. Lastly, the act makes changes related to the fees collected by the Department of Environment and Natural Resources in connection with brownfields agreements, effective when the act becomes law, August 4, 1999. These changes increase the application fee from $1,000 to $2,000, and increase the agreement fee from $500 to the actual cost to the State of all activities relating to the brownfields agreement. The $2,000 application fee is a credit against the agreement fee. These sections provide that interest on fees accrues to the Department's Brownfields Account rather than to the General Fund, that unpaid fees are a lien on all of the developer's property as well as on the brownfields property, and that the Department may contract for services necessary to implement the brownfields property law.

Brownfields property is abandoned, idle, or underused property at which expansion or redevelopment is hindered by actual or possible environmental contamination and that is or may be subject to cleanup requirements under State or federal law. Under current law, the Department of Environment and Natural Resources can enter into a brownfields agreement with the owner of brownfields property, under which the owner is allowed to clean up the property to a level that will allow the property to be used for specified purposes but would not meet current cleanup standards. The owner agrees to clean up the property as specified in the agreement and to limit future uses of the property to those specified in the agreement, i.e., uses that are safe given the less than complete cleanup of the property. This agreement benefits the State by causing a contaminated property to be at least partially cleaned up and put to productive use in place of having a "greenfield" pristine site developed. Under the agreement, the owner is relieved of liability for further cleanup of the property.

MODIFY HISTORIC REHABILITATION CREDIT

Session Law #	Bill #	Sponsor
S.L. 1999-389	SB 251	Senator Horton

AN ACT TO ALLOW THE HISTORIC REHABILITATION TAX CREDIT TO BE ALLOCATED BY A PASS-THROUGH ENTITY TO ITS OWNERS AND TO REQUIRE CORPORATIONS THAT ARE REQUIRED TO PAY FEDERAL-ESTIMATED INCOME TAX BY ELECTRONIC FUNDS TRANSFER TO PAY STATE-ESTIMATED INCOME TAX BY ELECTRONIC FUNDS TRANSFER.

OVERVIEW: This act modifies the tax credit for rehabilitating income-producing historic property and it requires corporations that are required to pay federal income tax estimated payments by electronic funds transfer (ETF) to pay State income tax estimated payments by ETF. The Revenue Laws Study Committee recommended the latter change in House Bill 62, introduced by Rep. Gray. The House Finance Committee added the provisions of House Bill 62 to this act.

FISCAL IMPACT:

- Historic Rehabilitation Tax Credit: The fiscal impact of the tax credit changes is unclear.
- Corp. Income Tax Payable by EFT: The Department of Revenue estimates an annual gain of $334,662 to the General Fund from the EFT requirement.

EFFECTIVE DATE:

- Historic Rehabilitation Tax Credit: The changes to the tax credit for rehabilitating income-producing historic property are effective for taxable years beginning on or after January 1, 1999.
- Corp. Income Tax Payable by EFT: The requirement for corporations to pay State income tax estimated payments by EFT becomes effective for taxable years beginning on or after January 1, 2000.

BACKGROUND & ANALYSIS:

Historic Rehabilitation Tax Credit. This act modifies the tax credit for rehabilitating income-producing historic property in two substantive ways and one technical way:

- It allows a pass-through entity, such as a Subchapter S corporation, to allocate the credit among any of the entity's owners, as long as the amount of credit allocated does not exceed the owner's adjusted basis in the pass-through entity. The credit amount may be allocated among any of the pass-through entity's owners, in the entity's discretion. The allocation provision sunsets in three years. Under prior law, the credits were allocated in the same proportion as other income items allocated to the owners under the Code.
- It adds provisions to recapture the credit if the taxpayer is required to recapture the credit under the Code or if a partner or owner disposes of its interest in the pass-through entity.
- It consolidates the credits for rehabilitating an historic property into one tax Article. The credits are currently duplicated in two separate statutes in the individual and corporate parts of the income tax Article in Chapter 105.

Taxpayers are allowed an income tax credit of 20% of the expenses of rehabilitating an income-producing historic structure and a credit of 30% of the expenses of rehabilitating an historic structure that is not income-producing. The credit for income-producing structures is lower because federal law also allows a 20% credit for those expenses, yielding a combined credit of 40%. The 20% credit is allowed only if the taxpayer qualifies for the federal credit and the 30% credit is allowed only if the taxpayer does not qualify for the federal credit. The credit may not be taken for the tax year the property is placed in service but must be taken in installments over five years after the historic structure is placed in service. Any unused portion of a credit may be carried forward for a five-year period.

A pass-through entity may qualify for the rehabilitation credits and pass the credits on to its owners. A pass-through entity is an entity, such as a partnership, a limited liability company, or a Subchapter S corporation, that is treated as owned by individuals or other entities under federal tax law and whose income, losses, and credits are reported by the owners on their State income tax returns.

Under the Code, tax credits are allocated among S corporation shareholders in accordance with their pro rata share of the corporation, which is determined on the basis of stock ownership, and tax credits are allocated among partners in a partnership in accordance with the partnership agreement. The allocation made by the partnership agreement must have a substantial economic effect, which means that the allocation agreement must reflect the economic interest of the partners in the partnership and cannot be based solely on tax consequences. Therefore, the allocation agreement of partners cannot give one partner 100% of the income, loss, or credits of the partnership. Under prior North Carolina law, the pass-through entity was

required to allocate a tax credit among its owners in the same proportion that other items, such as the federal rehabilitation credit, were allocated under the Code. This meant that if foreign investors were involved in a qualifying rehabilitation project, their tax credits could not be redistributed to North Carolina investors with State income tax liability.

In putting together an investment group for an income-producing historic rehabilitation project, the project sponsors may find some investors that can benefit from only the federal credit, because they have little or no North Carolina tax liability, and other investors that can benefit from both the federal and the North Carolina credit because they have both types of tax liability. This act changes the allocation of the credit to allow the maximum tax credit available for each of the project investors. It allows a pass-through entity to allocate the credit for rehabilitating an income-producing historic structure among any of its owners, as long as the amount of the allocated credit does not exceed the owner's adjusted basis in the entity, as determined under the Code. The adjusted basis is determined at the end of the taxable year in which the historic structure is placed in service. Each year an allocated credit is claimed, the pass-through entity and its owners must include a statement with their tax return that shows both the allocation made and the allocation that would otherwise have been required under G.S. 105-131.8 and G.S. 105-269.15. G.S. 105-131.8 provides that the tax credit allowed a shareholder in a Subchapter S corporation is based on the percentage of stock held by the shareholder in the corporation. G.S. 105-269.15 provides that the tax credit allowed a partner is based on the partnership agreement, which must have substantial economic effect.

The act also requires forfeiture of all or part of the credit for an income-producing historic structure when the following occurs:

- Forfeiture for Disposition. -- When a taxpayer is required by the Code to recapture part or all of the federal credit, then the taxpayer must forfeit the corresponding part of the State credit. Under the Code, the recapture does not apply if the property is disposed of because of the death of the taxpayer, a mere change in form of doing business, or a transfer between spouses or incident to a divorce.

- Forfeiture for Change in Ownership. -- If an owner of a pass-through entity that qualified for the credit disposes of all or a portion of the owner's interest in the pass-through entity within five years after the date the structure was placed in service so that the owner's interest is reduced to less than 2/3 of its interest at the time the structure was placed in service, the owner must forfeit a portion of the credit. This recapture does not apply if the change in ownership is due to the death of the owner or to a merger or consolidation requiring approval of the members of the taxpayer pass-through entity to the extent the entity does not receive cash or property.

If a taxpayer or owner of a pass-through entity forfeits the credit, then the taxpayer or owner is liable for all past taxes avoided plus interest. The past taxes and interest are due 30 days after the credit is forfeited.

Electronic Funds Transfer. The act requires corporations that are required to pay federal income tax estimated payments by EFT to pay State income tax estimated payments by EFT, effective for taxable years beginning on or after January 1, 2000. This change in the law will eliminate thousands of returns, not payments, each year. It will enable the State to receive tax payments more quickly and thus gain three to five days of interest on the payments.

In 1993, the General Assembly authorized the Department of Revenue to collect taxes by EFT. The average tax payment must be at least $20,000 a month before the tax payment must be submitted by EFT. The $20,000 threshold applies separately to each tax. This act creates a

different rule for corporate estimated income tax payments in order to increase the efficiency of State tax collections and to conform the State's method of collecting corporate estimated income tax payments with federal law so that a taxpayer has only one set of rules to learn and follow. For federal purposes, a corporation whose depository taxes exceed $200,000 in a twelve-month period must pay its corporate income tax estimated payments by EFT. The federal regulations list the different types of depository taxes. Examples of depository taxes include social security taxes, withheld income taxes, and corporate estimated income taxes. The Internal Revenue Service raised the threshold from $50,000 to $200,000 in July 1999. The higher threshold will limit the EFT requirement to the largest 9% of taxpayers, but other taxpayers are expected to use EFT voluntarily.

1999 FEE BILL

Session Law #	Bill #	Sponsor
S.L. 1999-413	**HB 1289**	**Representative Luebke**

AN ACT TO SET THE PUBLIC UTILITY REGULATORY FEES, TO SET THE INSURANCE REGULATORY CHARGE, TO IMPOSE THE INSURANCE REGULATORY CHARGE ON SERVICE CORPORATIONS AND ON HEALTH MAINTENANCE ORGANIZATIONS IN THE YEAR 2000, TO ALLOW THE DEPARTMENT OF AGRICULTURE AND CONSUMER SERVICES TO IMPOSE FEES THAT REFLECT THE ACTUAL COST OF RENDERING THE SERVICE, AND TO LIMIT THE FEE THAT AN APPLICANT MUST PAY FOR A WATER QUALITY CERTIFICATION THAT IS REQUIRED FOR A PERMIT UNDER THE COASTAL AREA MANAGEMENT ACT OF 1974.

OVERVIEW: **This act makes three tax law changes and two fee changes; only the tax law changes are summarized here. This act sets the tax rates for the public utility regulatory fee for the 1999-2000 tax year and for the insurance regulatory fee for the 1999 calendar year. The act also expands the scope of the insurance regulatory fee to include health maintenance organizations and medical service corporations, effective beginning in the 2000 calendar year.**

FISCAL IMPACT:

- Public Utility Regulatory Fee: This fee is expected to generate $8.5 million.
- NC Electric M'ship Corp.: This fee is expected to generate $200,000.
- Insurance Regulatory Fee: The fee is set at 7% for the 1999 calendar year (the 1998 rate was 6%). This charge is expected to generate $20.65 million for the 1999-2000 fiscal year (an increase of $1.45 million over the previous year). In addition, effective in 2000, health maintenance organizations (HMO's) and medical services corporations will be required to pay the fee. This requirement will generate between $2.45 million and $2.8 million. *(See Background & Analysis section for more detailed information.*

EFFECTIVE DATE:

- Public Utility Regulatory Fee: 1999-2000 tax year
- NC Electric M'ship Corp.: 1999-2000 tax year
- Insurance Regulatory Fee: 1999 calendar year;

effective for HMOs and medical services corporations in 2000.

BACKGROUND & ANALYSIS:

Public Utility Regulatory Fee: The act sets the general rate for the public utility regulatory fee at 0.09% for the 1999-2000 fiscal year. This is the same rate that was in effect for the 1997-1998 fiscal year and is expected to generate $8.5 million. The utility regulatory fee is a tax that was first imposed in 1989. The proceeds of the fee are credited to the Utilities Commission and Public Staff Fund and used to defray the State's cost in regulating public utilities. The regulatory fee is imposed on all utilities that are subject to regulation by the North Carolina Utilities Commission. The fee is a percentage of the utility's North Carolina jurisdictional revenues. In general, jurisdictional revenue is revenue derived from providing utility service in North Carolina.

In addition to funding the State's cost in regulating public utilities, the money in the Utilities Commission and Public Staff Fund is currently used to finance the work of the Study Commission on the Future of Electric Service in North Carolina. The General Assembly established the Commission in 1997 to examine the cost, adequacy, availability, and pricing of electric rates and service in North Carolina to determine whether legislation is necessary to assure an adequate and reliable source of electricity and economical, fair, and equitable rates for all consumers of electricity in North Carolina.

Secondly, the act sets at $200,000 the special public utility regulatory fee imposed on the North Carolina Electric Membership Corporation, effective for the 1999-2000 fiscal year. The proceeds of the fee will be credited to the Utilities Commission and Public Staff Fund and used to defray the State's cost in regulating electric membership corporations. The 1999 General Assembly enacted S.L. 1999-180, which authorized electric membership corporations to form subsidiary corporations that may provide energy services and products, telecommunications services and products, and water and wastewater collection and treatment. The subsidiaries must fully compensate the electric membership corporation for its use of the corporation's personnel, services, equipment, and property. The Utilities Commission is charged with regulating this aspect of the subsidiary's business and, to pay for this regulation, S.L. 1999-180 levies a flat-rate regulatory fee to be paid by the North Carolina Electric Membership Corporation. The General Assembly must establish the fee amount each year. The North Carolina Electric Membership Corporation is the only electric membership corporation in North Carolina whose principal purpose is to furnish or cause to be furnished bulk electric supplies at wholesale, as provided in G.S. 117-16. It is a "generation and supply cooperative" owned by its members. Its members are all but one of the existing North Carolina electric membership corporations, which are "distribution cooperatives." Thus, the fee imposed on the North Carolina Electric Membership Corporation will be passed on to its member electric membership corporations.

Insurance Regulatory Fee: First, the act sets the insurance regulatory charge at 7% for the 1999 calendar year, an increase from the 6% rate in effect for 1998. The charge is expected to generate $20.65 million for the 1999-2000 fiscal year, an increase of $1.45 million over the previous year. The insurance regulatory charge is a tax that was enacted in 1991 to make the Department of Insurance receipt-supported and thereby eliminate General Fund support for the Department. The charge is a percentage of each insurance company's premiums tax liability.

Second, the act imposes the insurance regulatory charge on health maintenance organizations and medical service corporations, effective beginning in 2000. The fee will be levied on each

company's hypothetical gross premiums tax liability determined at the 1.9% gross premiums tax rate applied to its premiums base. The hypothetical calculation is necessary because medical service corporations pay premiums tax at a rate of 0.5% rather than 1.9% and because health maintenance organizations do not pay premiums tax. Adding health maintenance organizations and medical service corporations to the insurance regulatory charge will increase the base against which the charge is levied by $35 to $40 million. At a regulatory charge rate of 7%, this would generate $2.45 to $2.8 million in proceeds.

Prior to the enactment of this act, the insurance regulatory charge was imposed only on insurance companies that pay the gross premiums tax, other than medical service corporations such as Blue Cross Blue Shield and Delta Dental Corporation, which were exempt. Health maintenance organizations did not pay the regulatory charge because they do not pay the gross premiums tax. Prior to 1995, these entities contributed to the Department of Insurance Fund through insurance audit and examination fees. However, in 1995, the General Assembly eliminated the insurance audit and examination fees for insurance companies, health maintenance organizations, medical corporations, and guaranty associations. The revenue generated by these audit fees was an estimated $4.5 million annually. The costs of the audits are now paid for by the insurance regulatory charge as part of the costs of regulating the insurance industry. This act distributes the responsibility for funding the Department of Insurance among all the entities that it regulates.

PENSION TAX WITHHOLDING

Session Law #	Bill #	Sponsor
S.L. 1999-414	**HB 1466**	**Representative Cansler**

AN ACT TO PROVIDE FOR WITHHOLDING OF NORTH CAROLINA INCOME TAXES FROM TAXABLE PENSIONS, ANNUITIES, AND DEFERRED COMPENSATION.

OVERVIEW: This act requires a person paying pensions, annuities, and deferred compensation to withhold North Carolina individual income tax from the payments unless the recipient elects not to have the tax withheld, effective January 1, 2001. Income that is exempt from tax is exempt from this withholding requirement. Therefore, the act does not apply to federal, State, and local retirees with five years of creditable service as of August 12, 1989, because these groups are exempt from State income tax due to a court decision in the Bailey, Emory, and Patton lawsuits.

FISCAL IMPACT: Unable to determine.

EFFECTIVE DATE: Taxable years beginning on or after January 1, 2001.

BACKGROUND & ANALYSIS: Under federal law, withholding is required on pensions, annuities, and certain deferred income, including IRAs. Prior to this act, North Carolina has not piggybacked this aspect of federal law. This act provides that a pension payer required to withhold federal income tax on a pension payment to a resident of North Carolina must also withhold State income tax. A recipient may elect to not have tax withheld from the pension payment. The pension payer must notify each recipient of the right to elect not to have tax withheld. An individual who elects not to have tax withheld from the pension payment must estimate their income tax liability each year and pay the tax in four installments.

In the case of periodic payments, the pension payer must withhold as if the recipient were a married person with three exemptions, unless the recipient provides an exemption certificate reflecting a different filing status or number of exemptions. For a non-periodic payment, the pension payer must withhold 4% of the payment. A pension payer who fails to withhold or remit the tax that is withheld is liable for the tax.

Currently, the Department of Revenue allows voluntary withholding by employers. The holder of an IRA, although not an employer, may also enter into a voluntary withholding agreement. However, if the payer withholds the tax but does not pay it to the Department of Revenue, the taxpayer's only recourse is against the payer. The Department cannot credit the taxpayer and pursue the payer. Under this act, effective for taxable years beginning on or after January 1, 2001, the withholding will be mandatory unless the recipient elects not to have the tax withheld.

UPDATE CODE/CRIMINAL DEADLINE/RESEARCH

Session Law #	Bill #	Sponsor
S.L. 1999-415	**HB 1476**	**Representative Miller**

AN ACT TO UPDATE THE REFERENCE TO THE INTERNAL REVENUE CODE USED IN DEFINING AND DETERMINING CERTAIN STATE TAX PROVISIONS, TO EARMARK PART OF THE RESULTING REVENUE GAIN FOR TAX RESEARCH, TO DIRECT THE STATE AUDITOR TO CONDUCT A PERFORMANCE AUDIT OF THE DEPARTMENT OF REVENUE, TO CONFORM TO THE FEDERAL STATUTE OF LIMITATIONS FOR WILLFUL FAILURE TO COMPLY WITH STATE TAX LAWS, AND TO INCREASE THE AMOUNT OF TIME A TAXPAYER HAS TO PROTEST THE PAYMENT OF A TAX.

OVERVIEW: This act makes the following changes relating to tax law:

- **Update IRC Reference.** It rewrites the definition of the Internal Revenue Code used in State tax statutes to change the reference date from September 1, 1998, to June 1, 1999. This change became effective August 5, 1999.
- **Conform Criminal Deadline to Federal.** It conforms the State statute of limitations, with respect to the willful failure to comply with the State's tax laws, to the federal statute of limitations. This change is effective December 1, 1999, and applies to prosecutions brought on or after the date for cases where the existing statute of limitations had not expired prior to December 1, 1999.
- **Extend Protest Period.** It increases the amount of time a taxpayer has to protest the payment of a tax from one year to three years. This change is effective for taxes paid on or after January 1, 1999.
- **Dept. of Revenue Tax Research Positions.** It earmarks part of the revenue generated by this act to pay for four new tax research positions for the Department of Revenue, as recommended by the Revenue Laws Study Committee. This change became effective August 5, 1999.
- **Performance Audit.** It earmarks part of the revenue generated by this act for a performance audit of the Department of Revenue, to be conducted by the State Auditor,

addressing technology issues, internal organization, budgeting and fiscal management, staffing, and other issues. This change became effective August 5, 1999.

FISCAL IMPACT: The Code Update is expected to increase General Fund revenues by $11.55 million in fiscal year 1999-2000, $2.95 million in fiscal year 2000-2001, $1.4 million in fiscal year 2001-2002, $900,000 in fiscal year 2002-2003, and $100,000 in fiscal year 2003-2004.

EFFECTIVE DATE: *See Overview section.*

BACKGROUND & ANALYSIS:

Update Code Reference. Updating the Internal Revenue Code reference makes recent amendments to the Code applicable to the State to the extent that State law previously tracked federal law. This update generally has the greatest effect on State corporate and individual income taxes because these taxes are based on federal taxable income and are therefore closely tied to federal law.

Since the General Assembly updated the State's reference to the Internal Revenue Code to September 1, 1998, Congress has enacted two bills that affect the Code. On October 21, 1998, the President signed into law Public Law 105-277, which includes the Tax and Trade Relief Extension Act of 1998. On April 19, 1999, the President signed into law Public Law 106-21, which extends the tax benefits available with respect to services performed in a combat zone to services performed in the Kosovo area.

Public Law 105-277: This federal law extended the research and development credit, created or extended tax breaks aimed particularly at individuals, small businesses, and farmers, narrowed some tax exemptions, and made many technical changes. The following is a summary of some of the more significant provisions:

- It extends the research and development credit through June 30, 1999. North Carolina's credit for research and development is based upon this federal credit.
- It accelerates the deduction for health insurance costs of self-employed individuals. Self-employed individuals are entitled to deduct a portion of the amount paid for health insurance for the self-employed individual and the individual's spouse and dependents. Under prior law, the amount that could be deducted was being phased up from 45% in 1998 to 100% in 2007. Public Law 105-277 accelerated the amount that could be deducted to 60% for tax years beginning in 1999 through 2001, to 70% for tax years beginning in 2002, and to 100% for tax years beginning in 2003 and thereafter. This change will treat the self-employed the same as employees, who may exclude from income 100% of employer-provided health insurance.
- It provides a five-year net operating loss carryback for farmers, effective for net operating losses arising in taxable years beginning after December 31, 1997. A net operating loss is the amount by which business deductions exceed business gross income. Generally, a net operating loss may be carried back two years and forward 20 years to offset taxable income in such years. Public Law 105-277 created an exception for farming losses. A farming loss is defined as the amount of any net operating loss attributable to the income and deductions of a farming business.
- It permanently extends the income averaging provision for farmers. An individual engaged in a farming business may elect to compute current year tax liability by averaging, over the prior three-year period, all or a portion of the taxable income that

is attributable to the farming business. This provision would have expired for taxable years beginning on or after January 1, 2001.

- It allows a taxpayer that wins a contest, lottery, jackpot, etc., and elects to take the payment as an annuity to claim the prize winnings as income at the time they are received. Prior to the enactment of this law, a person who had the option of receiving either a lump-sum distribution or an annuity was required to include the value of the award in gross income in the year in which the prize was won, even if the annuity option was exercised.
- It permanently extends the charitable market-value deduction for contributions of qualified appreciated stock to private foundations.
- It limits specified liability losses to product liability losses and amounts allowable as a deduction that are in satisfaction of a liability under a federal or state law requiring reclamation of land, decommissioning of a nuclear power plant, dismantlement of a drilling platform, remediation of environmental contamination, or a payment under any workers compensation act. A specified liability loss may be carried back 10 years rather than being limited to the general two-year carryback period. Prior to the enactment of this law, a specified liability loss included other liabilities that arose under federal or state law or out of any tort of the taxpayer.
- It requires certain deductible liquidating distributions of a regulated investment company or real estate investment trust to an 80% corporate owner to be included in the corporation's income.

Public Law 106-21: This federal law extends the tax benefits available under the Internal Revenue Code with respect to services performed in a combat zone to services performed in a "qualified hazardous duty area". The term "qualified hazardous duty area" means any area of the Federal Republic of Yugoslavia, Albania, the Adriatic Sea, and the northern Ionian Sea during the period that any member of the Armed Forces of the United States is entitled to combat pay for services performed in the area.

Under the Code, all or most of military personnel's combat pay is exempt from income tax. Since North Carolina begins its calculation of taxable income with federal taxable income, this pay is also exempt from State income tax. The Code also extends the time military personnel and those serving in support of the military personnel have to file and pay their taxes. Public Law 106-21 extends these provisions to those individuals within the "qualified hazardous duty area" defined above and to those individuals supporting Operation Allied Force who are away from their permanent duty stations.[11] The extension lasts until 180 days after taxpayers leave the defined areas or their supporting operation, plus the number of days they were there during the tax filing season after the air strikes began on March 24, 1999. The tax relief provisions also apply during any period of hospitalization resulting from injuries or illness incurred while serving in the combat zone. During the extension, affected taxpayers will not accrue any interest or penalty charges and the IRS will not pursue any tax enforcement action. G.S. 105-249.2 prohibits the Secretary of Revenue from assessing interest or a penalty against a taxpayer for any period that is disregarded for federal income tax purposes.

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[11] Operation Allied Force began on March 24, 1999, when U.S. military forces, acting with NATO allies, commenced air strikes against Serbian military targets in the Former Yugoslavia. On June 20, 1999, Operation Allied Force was officially terminated.

Background for Code Update. Since the State corporate income tax was changed to a percentage of federal taxable income in 1967, the reference date to the Internal Revenue Code has been updated periodically. In discussing bills to update the Code reference, the question frequently arises as to why the statutes refer to the Code on a particular date instead of referring to the Code and any future amendments to it. The answer to the question lies in both a policy decision and a potential legal restraint.

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

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

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

Conform Criminal Deadline to Federal. Under North Carolina law, it is a Class 1 misdemeanor to willfully fail to collect, withhold, or pay over taxes or to willfully fail to file a return or pay the tax due. Under prior law, the State had three years from the date of the violation to prosecute the taxpayer that violated the tax law. Under federal law, the IRS has six years from the date of the prosecution to pursue the violation. Sections 2 and 3 of this act conform the State statute of limitations to the federal statute of limitations by extending the time the State has to pursue a violation of the tax laws from three years to six years. This change is effective December 1, 1999, for cases where the three-year statute of limitations has not already expired.

Extend Protest Period. The act extends the time a taxpayer has to challenge the unconstitutionality of most taxes from one year to three years, effective for taxes paid on or after January 1, 1999. The time limit remains at 30 days for excise taxes on alcoholic beverages, soft drinks, tobacco products, and controlled substances. In North Carolina, if a taxpayer believes a tax is unconstitutional, the taxpayer must pay the tax and contest the tax by requesting a refund after paying the tax. This procedure is known as "paying under protest".

Tax Research Positions. Upon recommendation of the Revenue Laws Study Committee, the act authorizes the Secretary of Revenue to draw funds from the revenues generated by updating the Internal Revenue Code reference to fund four tax research positions in the Department of Revenue, effective January 1, 2000. The Revenue Laws Study Committee

determined that there is a need for in-depth tax research that cannot be met by the current three-person staff. Adding four new tax analyst positions would provide a tax research resource capable of serving the needs of the legislative and executive branches for analyses of various tax proposals and of the effect of changes in the economy on the tax base.

Performance Audit. The act directs the Office of the State Auditor to conduct a performance audit of the Department of Revenue, addressing the following areas: (i) tax collection and tax auditing activity, with particular attention to the cost, efficiency, and effectiveness of the Integrated Tax Administration System and subsequent automation projects; (ii) current methods of processing tax returns and payments and the ability to employ the latest technology in this processing; (iii) internal organization and management; (iv) budgeting and fiscal management; (v) current and future staffing requirements; and (vi) any other issues the State Auditor considers necessary or desirable. The State Auditor is to submit an interim progress report to the Senate and House Appropriations Subcommittee on General Government and the General Assembly's Fiscal Research Division by May 30, 2000, and a final report to the General Assembly by January 1, 2001. The Secretary of Revenue is directed to draw $100,000 from funds generated by the act to pay for the performance audit.

NO SALES TAX FEE/OTHER CHANGES

Session Law #	Bill #	Sponsor
S.L. 1999-438	**SB 1112**	**Senator Kerr**

AN ACT TO PROMOTE ELECTRONIC COMMERCE BY REPEALING THE SALES TAX REGISTRATION FEE AND TO MAKE OTHER CHANGES TO THE TAX LAWS AND RELATED STATUTES.

OVERVIEW: This act makes numerous tax law changes as described below:

- **Privilege Tax on Loan Agencies.** It reduces the annual privilege tax on loan agencies from $750.00 to $250.00. In addition, the act expands the scope of the tax to include pawnbrokers and check cashers. This change is effective July 1, 1999.
- **Repeal Sales Tax Registration Fee.** It repeals the one-time $15.00 registration fee retailers and wholesalers must pay when registering with the Department of Revenue for sales and use tax purposes. This change is effective January 1, 2000.
- **Repeal Sales Tax on Medical Equipment and Sundries.** It exempts durable medical equipment and medical sundries from sales tax. This change is effective October 1, 1999.
- **Repeal Sales Tax on Prescription Drugs.** It exempts physicians and other medical professionals who buy drugs to administer to their patients, and State hospitals (other than UNC hospitals) from paying sales and use tax on prescription drugs. (Note: other prescription drugs, including prescriptions, drugs purchased by the UNC hospitals, drug samples distributed by the manufacturer, and drugs purchased for use in the commercial production of animals, are either exempt from sales and use tax or the tax is refundable.) This change is effective October 1, 1999.
- **Repeal Sales Tax Exemption for Traded-In Items.** It repeals the sales tax exemption for certain traded-in items. This change is effective October 1, 1999.

- **Repeal Unconstitutional Sales Tax Provisions.** It repeals two sales tax provisions that may be unconstitutional: the requirement that a nonprofit corporation must be chartered in North Carolina in order to claim an exemption from collecting sales tax on items sold as a part of an annual fundraiser, and the sales tax exemption for sales of paper, ink, and other tangible personal property to commercial printers and publishers for use in free publications that contained advertising of a general nature. Both changes are effective October 1, 1999.

- **Airport Authority Sales Tax Refunds.** It entitles all local airport authorities created by the General Assembly to receive sales tax refunds. This change is effective July 1, 1999.

- **Tax Penalty and Assessment Changes.** It makes several changes to tax penalty and assessment rules, including authorizing the Secretary of Revenue to waive bad check penalties in the same manner as other penalties are waived, and conforming the negligence penalty for large corporate income tax deficiencies with other large tax deficiencies. The tax penalty changes are effective October 1, 1999, and the assessment changes are effective August 10, 1999.

- **Special Mobile Equipment Changes.** The act allows untaxed diesel fuel to be used in special mobile equipment, effective October 1, 1999, and also allows a quarterly refund for tax paid on any taxed motor fuel used to operate special mobile equipment, effective for taxes paid on or after January 1, 1999. It also increases the registration fee for special mobile equipment from $20.00 to $40.00, effective January 1, 2000. Finally, it expands the maximum width of special mobile equipment from 96 inches to 102 inches, effective August 10, 1999.

- **Miscellaneous Tax Law Changes.** The act also makes the following minor tax law changes:

    - Political Parties Financing Fund. Requires that the individual income tax return contain a line authorizing a contribution to the Political Parties Financing Fund, effective August 10, 1999.

    - Definition of a Utility for Sales Tax Purposes. Clarifies the definition of a utility for sales tax purposes, effective August 10, 1999.

    - No Sales or Use Tax/Certain Tangible Personal Property. Provides that sales and use taxes do not apply to tangible personal property that a merchant manufactures or purchases for resale but then withdraws from inventory and donates to a governmental entity, effective October 1, 1999.

    - Increase Restaurant Service Charges Not Subject to Sales Tax. Increases the amount of the service charge that may be added to a restaurant patron's bill without being subject to sales tax, effective October 1, 1999.

    - Information Sharing/DOR and Law Enforcement. Authorizes the Department of Revenue to share information about excise taxes on tobacco, alcohol, and unauthorized substances with law enforcement officials, effective August 10, 1999.

    - Repeal Certain Motor Fuel Tax Licenses. Repeals the requirement that bulk-end users and retailers of undyed diesel fuel obtain a motor fuel tax license, and clarifies that a motor fuel supplier is allowed a discount of the tax due only if

the tax is paid on time, effective August 10, 1999. Repeals the requirement that a bonded importer of motor fuel was required to obtain an import confirmation number, effective August 10, 1999.

- DOR Authorized to Use Certain Information. Authorizes the Department of Revenue to use information in the State Directory of New Hires to administer tax collection, effective August 10, 1999.

FISCAL IMPACT: Taken as a whole, the act is expected to increase General Fund revenues by less than $1 million a year the first three years it is in effect and then reduce General Fund revenues by less than $1 million a year the next two years it is in effect.

EFFECTIVE DATE: *See Overview section.*

BACKGROUND & ANALYSIS:

Privilege Tax on Loan Agencies. Under prior law, loan agencies were subject to an annual privilege tax of $750. Effective July 1, 1999, Section 2 of this act reduces the tax to $250 a year and expands its scope to apply to pawnbrokers and check cashers. This change is expected to reduce General Fund revenues by less than $300,000 a year. Pawnbrokers and check cashers are engaged in a similar business as loan agencies; the intent of the act is that similar taxpayers should be treated the same. Earlier versions of the bill would have retained the tax at $750, but the tax was reduced in response to complaints from pawnbrokers. The privilege tax statute caps at $100 the local privilege tax that counties and towns may levy on these businesses. Under former law, counties and towns were authorized to levy a local privilege tax of up to $275 on pawnbrokers.

Repeal Sales Tax Registration Fee. Under prior law, retailers and wholesalers were required to pay a fee of $15 when registering with the Department of Revenue for sales and use tax purposes. Registration is a one-time requirement before a merchant can begin a business that is subject to sales or use tax. Sections 1 and 1.1 of this act repeal the $15 fee effective January 1, 2000. Eliminating the fee will enable the Department of Revenue to handle registrations electronically. This change is expected to reduce General Fund revenues by approximately $540,000 a year.

Repeal Sales Tax on Medical Equipment and Sundries. Section 5 of this act exempts from sales tax durable medical equipment and medical sundries that are eligible for coverage under Medicare and Medicaid, effective October 1, 1999. This change is expected to reduce General Fund revenues by approximately $700,000 a year. The new exemption applies only to items purchased on prescription or by a certificate of medical necessity. While the item must be eligible under Medicare or Medicaid, the exemption applies whether or not it is purchased by a beneficiary under those programs. Durable medical equipment includes a variety of medical items such as wheelchairs, IV bag holders, and cane stands. Medical sundries are items that are easily and frequently disposed of, like latex gloves, gauze, medical tape, and syringes.

Repeal Sales Tax on Prescription Drugs. Sections 6 and 7 of this act exempt from sales tax all prescription drugs, effective October 1, 1999. This change is expected to reduce General Fund revenues by approximately $2 million a year. Under prior law, most prescription drugs were already either exempt from State and local sales and use taxes or refundable. The prior exemptions for prescription drugs applied to drugs purchased with a prescription (G.S. 105-164.13(13)), prescription drugs distributed free of charge by the manufacturer of the drugs (G.S. 105-164.13(13b)), and prescription drugs purchased for use in the commercial production of animals (G.S. 105-164.13(2a)). Prescription drugs distributed free of charge by

the manufacturer include samples given to physicians to give to patients and drugs donated to groups such as the American Red Cross.

Most hospitals receive refunds of State and local sales and use taxes paid on prescription drugs they acquire. G.S. 105-164.14(b) allows all nonprofit hospitals, except those operated by the State, and all for-profit hospitals to receive refunds of State and local sales and use taxes paid on prescription drugs. G.S. 105-164.14(c) allows the University of North Carolina Hospitals at Chapel Hill to receive refunds of State and local sales and use taxes paid on prescription drugs acquired for use by the hospital. The State General Fund receives a refund of local sales and use taxes paid by the other State hospitals on prescription drugs.

Thus, after combining the exemptions and refunds for prescription drugs, the only entities that were paying tax on prescription drugs were physicians and other medical professionals who buy the drugs to administer to patients in the course of their practice and State hospitals, other than the UNC hospitals. The exemptions and refunds for prescription drugs had evolved over the years in a piecemeal fashion, leaving this small segment subject to the taxes.

In addition to the UNC hospitals, the State operates four psychiatric hospitals: Dorothea Dix Hospital, Broughton Hospital, Cherry Hospital, and John Umstead Hospital. The State also operates various Alcohol and Drug Treatment Centers and Mental Retardation Centers around the State. These centers are in-patient facilities similar to hospitals. State agencies generally do not receive a refund of State sales and use taxes. These agencies receive an appropriation from the State that includes the amount needed to pay sales and use taxes.

Repeal Sales Tax Exemption for Traded-in Items. Section 8 of this act simplifies the sales tax treatment of traded-in items by repealing the exemption for certain traded-in items, effective October 1, 1999. This change is expected to increase General Fund revenues by approximately $1.2 million a year. Under prior law, if a used item were traded-in on the purchase of a new item, the used item would not be subject to sales tax when it was resold if the person who traded it in paid the full amount of sales tax on the new item purchased. This law created problems for retailers who were required to retain the tax records on the new item with the used item to determine the sales tax treatment of the used item when it was resold. If the items in question were subject to a reduced tax rate, as farm equipment is, then upon resale the traded-in item would be subject to local but not State sales tax, an added complication for retailers. Under this section, traded-in items will be subject to full State and local sales tax, as other used items are.

Repeal Unconstitutional Sales Tax Provisions. Sections 9 and 10 of this act address two sales tax provisions that are probably unconstitutional. Under prior law, certain nonprofit corporations were not required to collect sales taxes on items sold as part of an annual fundraiser. To qualify for the exemption, the corporation was required to have been chartered in North Carolina for two years. This classification does not have a rational basis and thus probably violated the uniformity requirements of the constitution. Section 9 of this act repeals the requirement that the corporation be chartered in North Carolina, effective October 1, 1999. This change is expected to have a negligible impact on General Fund revenues.

Prior law granted a sales tax exemption for sales of paper, ink, and other tangible personal property to commercial printers and publishers for use as component parts in free circulation publications that contained advertising of a general nature. The exemption applied to general shoppers guides but not to more specialized guides, such as real estate guides. The first amendment of the United States Constitution does not allow a state to discriminate between publications based on their content. The prior law exemption clearly violated this rule by

exempting guides with general content but not those with narrower content. Section 10 of this act repeals the exemption, effective October 1, 1999, so that supplies sold for all free publications will be subject to tax on a uniform basis. This change is expected to increase General Fund revenues by approximately $2.5 million a year.

Airport Authority Sales Tax Refunds. Under prior law, a local airport authority created by local act of the General Assembly was entitled to an annual refund of sales and use taxes it paid if the local act creating it gave it all the rights of a municipality, declared it to be a municipality, or specifically authorized it to receive sales tax refunds. Section 14 of this act expands the refunds to all local airport authorities created by the General Assembly, effective for purchases made on or after July 1, 1999. This change is expected to reduce General Fund revenues by between $4,000 and $18,000 a year.

Under prior law, 24 of the 33 local airport authorities were authorized to receive the sales tax refunds. Each year, local bills would be introduced to grant refunds for additional airport authorities. Two were added in 1999 by S.L. 1999-104. Because there appeared to be no reason to distinguish between those authorities entitled to refunds and those not entitled to refunds, Section 14 provides that all local airport authorities will be treated alike and local bills will no longer be necessary to add airport authorities one by one to the refund provision.

The refunds apply to direct purchases of tangible personal property. They also apply to sales and use tax liability indirectly incurred by a local airport authority on building materials, supplies, fixtures, and equipment that become a part of any building that is owned or leased by the authority and is being built, altered, or repaired for use by the authority. To obtain a sales and use tax refund, an authority must request the refund in writing within six months after the end of its fiscal year. The request must include any information and documentation required by the Secretary of Revenue.

Tax Penalty and Assessment Changes. Sections 15, 16, 17, and 19 of this act make changes in tax penalties and tax assessment rules. The tax penalty changes are effective October 1, 1999, and the assessment changes are effective August 10, 1999. No estimate is available of the impact these changes will have on General Fund revenues.

Under prior law, the Secretary of Revenue was permitted to waive all tax penalties except the penalty for bad checks. The exception had been made at the request of the Department of Revenue to reduce the administrative burden of having to consider and act on waiver requests with respect to bad checks. Sections 15 and 17 repeal the exception for the bad check penalty, so that all tax penalties will be subject to the same waiver authority. This change is not expected to have a significant impact on General Fund revenues. The penalty for bad checks is 10% of the amount of the check, with a minimum of $1 and a maximum of $1,000.

Under prior law, there were three general categories of negligence penalties: a general negligence penalty of 10% and two large tax deficiency penalties of 25%. The large negligence penalty applied to income tax only if the taxpayer understated taxable income by an amount equal to ¼ or more of gross income. The large negligence penalty applied to other taxes if the taxpayer understated tax liability by ¼ or more. The large deficiency test for income taxes is more forgiving than the stricter large deficiency test for other taxes. Section 16 of this act, requested by the Department of Revenue, limits the more forgiving large deficiency test to individual incomes taxes and moves corporate income taxes to the stricter large deficiency test that applies to other taxes.

The authority of the Department of Revenue to assess taxes and to make refunds of taxes is subject to statutory time limitations. Under prior law, a taxpayer that is under investigation by

the Department of Revenue could voluntarily waive the time limit for assessments in order to allow time for the investigation to be completed properly. The time limit for making refunds could not be extended, however. Thus, if the additional investigation to which the taxpayer agreed showed that a refund, rather than an assessment, was appropriate, the refund could not be made. Section 19 of this act, requested by the Department of Revenue, modifies the tax refund time limitations to state that the taxpayer's extension of the assessment time limits automatically extends the time in which the taxpayer can request a refund.

Special Mobile Equipment Changes. Sections 22, 24, and 27 through 29 of this act make changes related to special mobile equipment. Special mobile equipment is a vehicle that has a permanently attached crane, mill, ditch-digging apparatus, or similar attachment. The vehicle is driven on the highway only to get to and from a non-highway job. It is not designed or used primarily for the transportation of persons or property.

Sections 22, 24, and 27 address a problem relating to motor fuel tax. The motor fuel tax is designed to apply only to fuel used for highway purposes. Motor fuel used for non-highway purposes is instead subject to sales tax. Thus, special mobile equipment should not have to pay motor fuel tax on the fuel it uses for non-highway purposes. However, under prior law, it could not use dyed (untaxed) diesel fuel and was not authorized to receive a refund of motor fuel tax paid on clear (taxed) diesel fuel. Section 22 of this act provides that dyed (untaxed) diesel fuel may be used in special mobile equipment, effective October 1, 1999. Section 24 of this act allows a quarterly refund for tax paid on motor fuel used to operate special mobile equipment off-highway, effective for taxes paid on or after January 1, 1999. As a result of these changes, the motor fuel used in special mobile will be subject to sales tax rather than motor fuel tax. This change will result in a small but unknown reduction in Highway Fund revenues and a corresponding increase in General Fund revenues. Section 27 of this act increases the registration fee for special mobile equipment from $20 to $40, effective January 1, 2000. This increase should generate about $40,000 or more in annual Highway Fund revenues to offset the decrease that will result from the motor fuel tax changes in Sections 22 and 24.

Section 28 of this act expands the maximum width of special mobile equipment from 96 inches to 102 inches. Section 29 of this act provides that vehicles being towed by special mobile equipment may carry property that does not exceed the weight of the towed vehicle. These sections, effective August 10, 1999, conform the law to reflect prevailing practices with regard to special mobile equipment.

Miscellaneous Changes. The remaining sections of this act make minor changes to various tax law statutes.

- Political Parties Financing Fund. The law requires that the individual income tax return contain a line authorizing a contribution to the Political Parties Financing Fund. Section 3 of this act removes the requirement that the line be color-contrasted with the color scheme of the remainder of the return. Beginning next year, income tax returns will have a uniform ink color for purposes of optical character reading. With the implementation of optical character reading, the color contrast requirement is not compatible with efficient processing of the millions of tax returns filed each year because the contrast color would interfere with recognition of the proper fields.

- Definition of a Utility for Sales Tax Purposes. Sections 4 and 12 clarify the definition of a utility for sales tax purposes. Under prior law, the definition contained a sales exemption for municipalities that are supplied electricity by the federal government and are required to make payments in lieu of taxes. These sections move the exemption from

the definition statutes to the exemption statutes. Under prior law, the definition included electric power companies subject to the gross receipts tax under G.S. 105-116. In anticipation of a possible rewrite of the gross receipts tax statutes as part of deregulation, these sections remove the cross-reference to the gross receipts tax and clarify that all sellers of electric power are considered utilities for sales tax purposes.

- No Sales or Use Tax/Certain Tangible Personal Property. Section 11 of this act provides that sales and use taxes do not apply to tangible personal property that a merchant manufactures or purchases for resale but then withdraws from inventory and donates to a governmental entity, effective October 1, 1999. This change is not expected to have significant impact on General Fund revenues. The prior law granted a tax exemption only for property donated to a nonprofit organization. In some cases, merchants donate property to schools or other governmental entities; this change allows these donations to benefit from the same sales tax exemption as donations to nonprofits. A wholesale merchant or retailer does not pay sales or use taxes when purchasing the products or the ingredients used to manufacture the products because the products are to be resold. Sales and use taxes do not apply to property purchased for resale or ingredients purchased to manufacture products for resale. If the wholesale merchant or retailer chooses not to sell the goods, the wholesale merchant or retailer becomes liable for use tax on the goods because the resale exemption no longer applies. Without these specific exemptions for donations, a merchant who donates to charity would become liable for sales and use tax.

- Increase Restaurant Services Charges Not Subject to Sales Tax. Section 13 of this act increases the amount of the service charge that may be added to a restaurant patron's bill without being subject to sales tax, effective October 1, 1999. Under prior law, sales tax applied to a service charge added to the sales price of food and beverages unless the service charge (1) did not exceed 15%, (2) was stated separately on the menu and the bill, and (3) was turned over to the personnel who served the meals. This section increases the maximum percentage of the service charge from 15% to 20%, to reflect the current practice in some restaurants. If the three conditions are met, the service charge is considered a tip and is not part of the sales price for sales tax purposes.

- Information Sharing/DOR and Law Enforcement. Section 18 of this act amends the tax secrecy law effective August 10, 1999, to allow the Department of Revenue to share with law enforcement agencies information about the tobacco products excise taxes, alcoholic beverages excise taxes, and unauthorized substances excise taxes, when this information is needed to fulfill a duty imposed on the Department of Revenue or on the law enforcement agency. The Department of Revenue works closely with law enforcement agencies to enforce the excise taxes on controlled substances and illicit liquor.

- Repeal Certain Motor Fuel Tax Licenses. Sections 20 and 21 of this act repeal the requirement that bulk end users and retailers of undyed diesel fuel get a motor fuel tax license, effective August 10, 1999. The licenses are not necessary because the Department of Revenue can obtain the same information from the Department of Agriculture and Consumer Services. Because there was no fee for these licenses, their repeal will have no fiscal impact.

  A motor fuel supplier that files a timely motor fuel tax return is allowed a discount of 0.1% of the tax due, not to exceed $8,000 a month, to cover the supplier's expenses

incurred in collecting the motor fuel tax. Section 23 of this act clarifies that the discount is allowed only if the tax is paid on time, effective August 10, 1999.

Under prior law, a bonded importer of motor fuel was required to obtain an import confirmation number using a transport truck to import fuel obtained from a supplier that is not a trustee for remittance of the motor fuel tax to the State on behalf of the importer. Section 25 of this act repeals this requirement effective August 10, 1999. The Department of Revenue requested this change, which is not expected to have any fiscal impact. The Department determined that the import confirmation number was not necessary because there are very few bonded importers in this category and the suppliers from whom they obtain the fuel have been collecting the tax and remitting it to the Department.

- DOR Authorized to Use State Directory of New Hires. Section 30 of this act allows the Department of Revenue to use information in the State Directory of New Hires for the purpose of administering the taxes it has a duty to collect. The State Directory of New Hires was established in 1997 to assist in the location of persons owing child support. The Department of Health and Human Services maintains the Directory. Every employer in the State must report to the Directory the hiring of every employee for whom a federal W-4 form is required to be completed. The report must contain the name, address, and social security number of the newly hired employee and the name, address, and federal and State tax ID numbers of the employer. This section became effective August 10, 1999.

TAX LIEN ADVERTISEMENT & COLLECTION

Session Law #	Bill #	Sponsor
S.L. 1999-439	**HB 120**	**Representative Owens**

AN ACT TO IMPROVE THE PROCEDURES FOR NOTIFYING OWNERS AND ADVERTISING TAX LIENS ON REAL PROPERTY.

OVERVIEW: This act makes the following changes relating to property tax collection, effective January 1, 2001:

- In the case of real property that the owner transferred after the January 1 visitation date, the taxing unit's newspaper advertisement of tax liens for delinquent taxes must be in the name of the person to whom the property was transferred.
- Before the newspaper advertisement is published, the tax collector must mail a notice to the listing owner and, if the listing owner has transferred the property after the visitation date, to the person to whom the property was transferred.
- It allows the taxing unit to begin in rem foreclosure proceedings 30 days after the tax liens are advertised, rather than waiting six months as required under prior law.

FISCAL IMPACT: Small, one-time impact on the costs of county operations.

EFFECTIVE DATE: January 1, 2001.

BACKGROUND & ANALYSIS: Property must be listed for property tax in January of each year. The listing owner is the taxpayer who owned the property as of January 1 (the visitation

date). The listing owner is liable for property taxes for the fiscal year beginning July 1 following the visitation date, even if the property is transferred to another person after the visitation date. The taxes become due in September and become delinquent on January 6 of the following year. Although most counties send tax listing notices and tax bills to the taxpayer, they are not required by law to do so. Property owners are charged with notice that they must list their property for taxes and pay the taxes; otherwise, enforcement measures will be taken against the property. The legal effect of this law is to prevent a taxpayer from using lack of notice as an excuse for not paying property taxes or as a defense to a collection remedy against the property.

If property taxes remain unpaid by February of the fiscal year in which they become due, the taxing unit (a county, city, or taxing district) is required by statute to order the tax collector to advertise the tax liens in a local newspaper under the name of the listing owner. This act provides that the tax collector must send a notice of the amount of the tax liens by first class mail at least 30 days before the tax lien advertisement is to be published. The notice must go to the person who listed the property (the listing owner) and, if the property was transferred during the one-year period beginning on the January 1 visitation date preceding the fiscal year in which the taxes become due, also to the person to whom the property was transferred (the record owner).

This act also changes the content of the tax lien advertisement. Under prior law, the advertisements contained the listing owners' names followed by a description of the property and the amount of delinquent tax due. This act provides that each parcel's tax lien will be noted under the record owner's name rather than the listing owner's name if the property was transferred after the January 1 visitation date preceding the fiscal year the taxes become due.

If delinquent property taxes remain unpaid after the advertisement of the tax lien, the tax collector may begin an in rem foreclosure proceeding against the property. Under prior law, the tax collector was required to wait six months after the advertisement before foreclosing. The earliest tax liens can be advertised is March; therefore, September was the earliest an in rem foreclosure proceeding could be initiated. Because a local government's fiscal year begins July 1, the collection of property taxes through an in rem foreclosure proceeding could not begin until the succeeding fiscal year after the taxes are due. This act allows the tax collector to initiate an in rem foreclosure proceeding as early as 30 days after the tax liens were advertised. This change enables collectors to collect the taxes in the fiscal year in which they are due.

REGIONAL TRANSPORTATION AUTHORITY AMENDMENTS

Session Law #	Bill #	Sponsor
S.L. 1999-445	**HB 937**	**Representative Gray**

AN ACT TO AMEND THE REGIONAL TRANSPORTATION AUTHORITY ACT CONCERNING JURISDICTION OF THE ENTIRE AREA OF THE COUNTY IN CERTAIN CIRCUMSTANCES AND MEMBERSHIP OF THE AUTHORITY, AND TO AUTHORIZE THE AUTHORITY TO CREATE SPECIAL TAX DISTRICTS WITHIN ITS JURISDICTION.

OVERVIEW: The act makes the following three changes affecting regional transportation authorities:

- **Jurisdiction of Piedmont Authority for Regional Transportation.** It expands the jurisdiction of a regional transportation authority (Piedmont Authority for Regional Transportation) to include the entire area of any county that has a member of its board of commissioners serving on the authority's board of trustees.
- **Membership of Piedmont Authority for Regional Transportation.** It expands the board of a regional transportation authority (Piedmont Authority for Regional Transportation) to include the chair of the airport authorities of the two most populous counties within the authority's jurisdiction.
- **Special Tax Districts.** It provides that a regional transportation authority (the Piedmont Authority for Regional Transportation) may create special tax districts consisting of one or more entire counties within the authority's jurisdiction and may levy its taxes within the special districts to the extent the taxes have not already been levied throughout the entire jurisdiction of the authority. The authority may not levy or increase a tax within the special district unless the board of commissioners of each county in the special district has adopted a resolution approving the levy or increase.

FISCAL IMPACT: The above changes affect only local revenues.

EFFECTIVE DATE: August 10, 1999.

BACKGROUND & ANALYSIS: In 1997, the General Assembly enacted S.L. 1997-417, which authorized a regional transit authority to levy a gross receipts tax of up to 5% on retailers within the region engaged in the business of renting passenger motor vehicles and motorcycles. The tax was expanded by S.L. 1999-452 to include property-hauling vehicles under 7,000 pounds. The tax applies only to short-term rentals, i.e., rentals for a period of less than one year. The tax is collected by the authority but is otherwise administered in the same way as the optional highway use tax on gross receipts from vehicle rentals. This optional highway use tax is 8% on short-term rentals, so the combined tax within the jurisdiction of the authority would be 13% if the authority levies the full 5%. Each authority may use the proceeds of the tax for its public transportation purposes. Before levying or increasing the tax, the authority must obtain approval from each county in the region.

A regional transit authority is a regional public transportation authority created under Article 26 of Chapter 160A of the General Statutes or a regional transportation authority created under Article 27 of Chapter 160A of the General Statutes. The authority created under Article 26 is the Triangle Transit Authority for Wake, Durham, and Orange Counties. The Authority created under Article 27 is the Piedmont Authority for Regional Transportation, which serves Forsyth, Guilford, Randolph, Davidson, and Alamance Counties.

The 1997 law also authorized the Piedmont Authority for Regional Transportation and any multi-county public transportation authorities organized under pre-existing law to levy a $5 vehicle registration tax identical to the tax already authorized for, and levied by, the existing Triangle Transit Authority. A public transportation authority is an entity created by one or more local government entities under Article 25 of Chapter 160A of the General Statutes to provide public transportation. There are three multi-county public transportation authorities. The Choanoke Public Transportation Authority consists of Bertie, Halifax, Hertford, and Northampton Counties. The Kerr Area Transportation Authority consists of Franklin, Granville, Person, Vance, and Warren Counties. The Inter-County Public Transportation Authority consists of Camden, Chowan, Currituck, Pasquotank, and Perquimans Counties.

An authority must obtain the approval of each county within its jurisdiction before it can levy the $5 vehicle registration tax. The Division of Motor Vehicles will collect the tax in counties that are entirely located within the authority's jurisdiction. If the authority's jurisdiction includes just part of one or more counties, the authority will collect the registration tax in those parts of counties. The authority may contract with local governments to collect this tax.

Jurisdiction of Piedmont Authority for Regional Transportation. Under prior law, the jurisdiction of a regional transportation authority created under Article 27 of Chapter 160A of the General Statutes (the Piedmont Authority for Regional Transportation) included all or part of five contiguous counties whose boards of commissioners have representatives on the board of trustees, and included parts of other contiguous counties if the boards of commissioners of the affected counties consented by resolution. The authority's board of trustees could choose to add a member of the affected county's board of commissioners to the board of trustees. Section 1 of the act provides that if a member of an affected county's board of commissioners has been added to the authority's board of trustees, the authority's jurisdiction includes the entire area of the county. By expanding the jurisdiction of an authority, this change expands the authority's taxing power.

Membership of Piedmont Authority for Regional Transportation. The act expands the membership of a regional transportation authority created under Article 27 of Chapter 160A of the General Statutes (the Piedmont Authority for Regional Transportation) to include the chair of the principal airport authority or airport commission of each of the two most populous counties within the authorities jurisdiction. In the case of the Piedmont Authority for Regional Transportation, this means the chair of the Forsyth County Airport Commission and the chair of the Piedmont Triad Airport Authority.

Special Tax Districts. A regional transportation authority (either the Triangle Transit Authority or the Piedmont Authority for Regional Transportation) may levy within its jurisdiction the vehicle rental tax of up to 5% and the vehicle registration tax of up to $5, as described above. The act provides that if a regional transportation authority created under Article 27 of Chapter 160A of the General Statutes (the Piedmont Authority for Regional Transportation) has not levied either tax up to the maximum rate, it may create a special tax district within its jurisdiction consisting of the entire area of one or more counties. The authority may levy within the special tax district the balance of either or both taxes, up to their maximum rates. The proceeds of a tax levied within a special tax district may be used only for public transportation purposes for the benefit of the special district. The levy and administration of a tax within a special district, like that of a tax within the entire jurisdiction of the authority, may not be levied unless there is a public hearing and each county in the special district has approved the tax. In addition, the authority may not levy or increase a tax within the special district unless the board of commissioners of each county in the special district has adopted a resolution approving the levy or increase.

MOTOR VEHICLE TECHNICAL AMENDMENTS

Session Law #	Bill #	Sponsor
S.L. 1999-452	**HB 280**	**Representative Cole**

AN ACT TO MAKE TECHNICAL, CLARIFYING, AND OTHER CHANGES TO THE MOTOR VEHICLE LAWS.

OVERVIEW: **This act makes numerous changes to the motor vehicle laws and two changes to the tax laws. The tax law changes are:**

- **Transit Authority Vehicle Rental Tax.** An expansion of the scope of the transit authority vehicle rental tax to include more types of vehicles.
- **DOR to Share Motor Fuel Tax Information.** An expansion of the Department of Revenue's authority to share motor fuel tax information to help in collecting motor fuel taxes.

FISCAL IMPACT: Insignificant impact.

EFFECTIVE DATE: October 1, 1999.

BACKGROUND & ANALYSIS:

Transit Authority Vehicle Rental Tax. Sections 26 through 28 of this act broaden the scope of the transit authority vehicle leasing tax to include certain property-hauling vehicles, effective October 1, 1999. A regional transit authority may levy a gross receipts tax on a retailer who leases or rents vehicles. The tax rate may not exceed 5% of the gross receipts derived from the short-term (less than 365 continuous days) lease or rental of the vehicles. This tax is added to the lease or rental price and paid by the lessee. This act broadens the scope of this tax from its current scope (U-drive-it passenger vehicles and motorcycles) to include U-drive-it property-hauling vehicles as well. A U-drive-it vehicle is defined in G.S. 20-4.01 as any of the following rented to a person who will operate it: a motorcycle; a property hauling vehicle under 7,000 pounds rented for a term of less than one year (and not hauling products for hire); and a private passenger vehicle rented for a term of less than one year (and not rented to public schools for driver training instruction).

A regional transit authority is a regional public transportation authority created under Article 26 of Chapter 160A of the General Statutes or a regional transportation authority created under Article 27 of Chapter 160A of the General Statutes. The authority created under Article 26 is the Triangle Transit Authority for Wake, Durham, and Orange Counties. The Authority created under Article 27 is the Piedmont Authority for Regional Transportation, which serves Forsyth, Guilford, Randolph, Davidson, and Alamance Counties.

DOR Authorized to Share Motor Fuel Tax Information. The tax secrecy law authorizes the Department of Revenue to exchange taxpayer information with the Division of Motor Vehicles to the extent necessary for these agencies to fulfill their duties. Section 28.1 of this act amends this provision to allow the Department of Revenue to exchange information with the International Fuel Tax Association, Inc., as well, effective October 1, 1999. The International Fuel Tax Association is a nonprofit, membership organization whose mission is to provide oversight, planning, and coordination of activities necessary to promote uniform administration of the International Fuel Tax Agreement (IFTA). The IFTA is an agreement between member taxing jurisdictions to assist each other in the collection and administration of taxes paid by interstate motor carriers on their use of motor fuel. These taxes are frequently referred to as road taxes or highway use taxes and are not to be confused with the motor vehicle titling tax enacted in 1989 that is also referred to as a highway use tax. The road tax is a tax on the amount of fuel a motor carrier uses in its operations in a state. The tax is at the same rate as the state's per-gallon excise tax on motor fuel and a credit is given for excise taxes paid to the state on motor fuel. Thus, the purpose of the tax is to tax motor carriers who drive in a state using fuel purchased in another state.

Under the IFTA, a motor carrier declares one member jurisdiction to be the carrier's base jurisdiction for registering the carrier's vehicles for purposes of the road taxes and reporting the taxes due to all the member jurisdictions. The base jurisdiction then collects the road taxes payable by the motor carrier to every member jurisdiction and remits the taxes collected to the appropriate jurisdictions. By centralizing the payment and collection of road taxes, the agreement greatly simplifies the payment of road taxes by motor carriers and the collection of road taxes by the member jurisdictions.

MUNICIPAL INCORPORATION PROCESS

Session Law #	Bill #	Sponsor
S.L. 1999-458	**HB 964**	**Representative Jarrell**

AN ACT TO REVISE THE MUNICIPAL INCORPORATION PROCESS SO AS TO PROVIDE MORE SCRUTINY.

OVERVIEW: This act makes four changes to the municipal incorporation process:

- **Changes to Criteria for Municipal Incorporation.**
  - It requires that a petition filed with the Joint Legislative Commission on Municipal Incorporations contain a statement that the proposed municipality will have a budget ordinance with a property tax levy of at least five cents per $100.00 valuation upon all taxable property within its corporate limits and that the proposed municipality will offer four municipal services no later than the first day of the third fiscal year following the date of incorporation. This change applies to municipalities for which the Commission makes recommendations on or after August 13, 1999.
  - It changes the criteria for incorporation that the Joint Legislative Commission on Municipal Incorporations considers when making its recommendation to the General Assembly on whether an area should be allowed to incorporate. Among these changes is the repeal of the development criteria in G.S. 120-169.1(a). This repeal is effective August 13, 1999.
- **Distribution of State-Shared Revenues and Local Sales Tax Revenues.**
  - It provides that a municipality, incorporated on or after January 1, 2000, may not receive local sales tax revenues or State-shared tax revenues unless it levies a property tax at a rate of at least five cents per $100.00 valuation upon all taxable property within its corporate limits, collects at least 50% of the property tax due, and provides at least four municipal services.
  - It provides that a municipality, incorporated on or after January 1, 2000, may not receive State-shared revenues or local sales tax revenues unless a majority of the mileage of its streets is open to the public.

The above changes, other than the repeal of the criteria for incorporation in G.S. 120-169.1(a), do not apply to any community that first filed a petition with the Joint Legislative Commission on Municipal Incorporations before July 20, 1999. These changes also do not apply to the

Community of Gray's Creek in Cumberland County nor to the Community of Union Cross in Forsyth County if either community files a petition with the Commission before July 1, 2002.

FISCAL IMPACT: Unable to determine.

EFFECTIVE DATE: *See Overview section.*

BACKGROUND & ANALYSIS: In 1985, the General Assembly created the Joint Legislative Commission on Municipal Incorporations. [12] Although a municipality does not need the recommendation of the Commission to be incorporated, it is highly encouraged. Also Rule 35.1 of the permanent rules of the Regular Sessions of the House of Representatives of the 1999 General Assembly requires that a municipality seeking incorporation have an assessment report from the Commission before the House of Representatives may consider it.

Criteria for Municipal Incorporation. Prior to this act the Commission was required to give the proposed area to be incorporated a positive recommendation if the area met all of the following criteria:

- Petition requirements and notice requirements have been met.
- The proposed municipality is not located within one mile of a city of 5,000 to 9,999; within three miles of a city of 10,000 to 24,999; within four miles of a city of 25,000 to 49,999; or within five miles of a city of 50,000 or more. G.S. 120-166(b) sets out four exceptions to this requirement.
- The proposed municipality has a permanent population of at least 100.
- At least 40% of the area is developed for residential, commercial, industrial, institutional, or governmental uses, or is dedicated as open space. This requirement does not apply if the entire proposed municipality is within two miles of the Atlantic Ocean, Albemarle Sound, or Pamlico Sound.
- None of the proposed municipality is located within an existing municipality.
- The proposed municipality can provide at a reasonable tax rate the services requested by the petition and also can provide at a reasonable tax rate the types of services usually provided by similar municipalities.
- The proposed municipality plans to provide at least two municipal services.

The act changes the above criteria for municipal incorporation as follows:

- It adds a new requirement that the proposed municipality have a proposed budget ordinance with a property tax rate of at least five cents per $100.00 valuation upon all taxable property within its corporate limits. This change applies to municipalities for which the Commission makes recommendations on or after August 13, 1999.
- It increases the number of services the proposed municipality must plan to provide from two to four. These services must be provided within the third fiscal year of incorporation. The types of services the municipality can offer include police protection, fire protection, solid waste collection or disposal, water distribution, street maintenance, street

[12] This Commission consists of two senators, two House members, one city manager or elected city official, and one county commissioner or county manager. (G.S. 120-158)

construction, street lighting, and zoning. This change applies to municipalities for which the Commission makes recommendations on or after August 13, 1999.

- It adds a requirement that the proposed municipality must have a population density of at least 250 persons per square mile. This is in addition to the pre-existing requirement of a permanent population of at least 100 persons. This change does not apply to any community that first filed a petition with the Commission before July 20, 1999.
- It removes the exception from the requirement that at least 40% of the area be developed for urban uses or dedicated as open space. This exception applied to a proposed municipality located within two miles of the Atlantic Ocean, Albemarle Sound, or Pamlico Sound. This change does not apply to any community that first filed a petition with the Commission before July 20, 1999.
- It repeals the development criteria set out in G.S. 120-169.1(a) of the General Statutes because it was in conflict with a pre-existing requirement for municipal incorporation. G.S. 120-169.1(a), enacted by the General Assembly in 1998, prohibited the Commission from making a positive recommendation on the proposed incorporation, unless the entire area met the development criteria for involuntary annexation set out in G.S. 160A-36(c) or G.S. 160A-48(c) of the General Statutes. These two sections of Chapter 160A required a higher percentage of urban use in the proposed municipality than the pre-existing requirement of 40% in G.S. 120-168. The repeal of G.S. 120-169.1(a) became effective August 13, 1999.
- It adds a requirement that the Commission must include in its report the impact on other municipalities and counties of the diversion of already levied local taxes and State-shared revenues to support services in the proposed municipality. This requirement does not apply to any community that first filed a petition with the Commission before July 20, 1999.

Distribution of State-Shared Revenues and Local Sales Tax Revenues. Cities receive the following State-shared taxes: the franchise tax in Article 3 of Chapter 105 on telephone companies, electric power companies, natural gas companies, and regional natural gas districts; the tax on motor fuel and alternative fuel in Articles 36C and 36D of Chapter 105; and the excise tax on malt beverages and wine in Part 4 of Article 26 of Chapter 105. Together these taxes contribute 10% to 25% of a city's general fund revenue. Under prior law, a municipality did not need to meet any conditions to receive local sales tax distributions. However, to receive motor fuel and alternative fuel tax revenue, known as Powell Bill funds, a municipality had to meet the following conditions:

- It has levied a pro[13]perty tax for the current fiscal year of at least five cents per $100.00 valuation upon all taxable property within its corporate limits.
- It has actually collected at least 50% of the total property tax levied for the preceding fiscal year.
- It has adopted a budget ordinance showing revenue received from all sources and showing that funds have been appropriated for at least two of the following services: water, wastewater, garbage collection, fire protection, police protection, street maintenance, or street lighting.

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Pursuant to G.S. 136-41.1, the Powell Bill funds are allocated to municipalities based upon the municipality's population and the municipality's mileage of public streets that are not part of the State highway system. A municipality may use Powell Bill funds only for the purpose of maintaining, repairing, constructing, reconstructing, or widening public streets.

Effective for municipalities incorporated on or after January 1, 2000, the act increases the number of services a municipality must offer from two to four in order to receive Powell Bill funds. It also places the same conditions on the other State-shared revenues as well as on local sales tax distributions. Therefore, for a municipality incorporated on or after January 1, 2000, to receive franchise tax revenues, malt beverage and wine tax revenues, and local sales tax revenues, it must meet all of the following conditions:

- It levies a property tax of at least five cents per $100.00 valuation.
- It collected at least 50% of the total property tax levied for the preceding fiscal year.
- Its adopted budget ordinance shows that funds have been appropriated for at least four of the following services – police protection, fire protection, solid waste collection, water distribution, street maintenance, street construction, street lighting, and zoning.

The act further bars the distribution of revenue to municipalities that do not have public streets. Effective for distributions of State-shared revenues and local sales tax revenues made on or after July 1, 1999, a municipality incorporated on or after January 1, 2000, may not receive State-shared revenues or local sales tax revenues, unless a majority of the mileage of its streets are open to the public. In recent years at least two municipalities have been incorporated that do not have streets open to the public. They are Grandfather Village in Avery County (S.L. 1987-419) and the newly incorporated Bermuda Run in Davie County (S.L. 1999-94). Since these two municipalities were incorporated before January 1, 2000, this restriction would not apply.

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Prepared by Cindy Avrette, Martha H. Harris, and Martha K. Walston

S.L. 1998-1 Extra Session (Senate Bill 2, Senator Rand)

AN ACT TO ESTABLISH THE HEALTH INSURANCE PROGRAM FOR CHILDREN AND TO AUTHORIZE A TAX CREDIT FOR CERTAIN PURCHASERS OF DEPENDENT HEALTH INSURANCE.

Section 5 of this act creates a refundable individual income tax credit for certain taxpayers who purchase health insurance for their dependent children. The credit is equal to $300 for those taxpayers with incomes below 225% of the Federal Poverty Level and $100 for those taxpayers above the 225% threshold. Taxpayers who have their health insurance premiums deducted from their income before it is taxed do not qualify for the credit. Taxpayers whose adjusted gross income is higher than the threshold amount set by the act do not qualify for the credit. The threshold amount for married filing jointly is $100,000 and the threshold amount for head of household is $80,000. The credit is effective for taxable years beginning on or after January 1, 1999, and it expires on the effective date of an act repealing the Health Insurance Program for Children established by this act. It is estimated that the tax credit will produce a General Fund revenue loss of $64.5 million in FY 1999-2000.

Governor Hunt convened the General Assembly in an extra session beginning March 24, 1998, to address the issue of uninsured children. In 1998, there were more than 71,000 uninsured children in North Carolina whose parents made too much money to qualify for Medicaid but who could not afford to purchase health insurance for their children. Under Title XXI of the Social Security Act, North Carolina had the opportunity to receive $79.9 million in federal money in order to provide health care for children if the State established a Health Insurance Program for Children that met federal guidelines.

This act establishes a Health Insurance Program for Children. To be eligible for the program, the person must be ineligible for other government-sponsored health insurance, be under the age of 19 and enrolled in school, be uninsured for six months prior to application, be in a family that meets the income requirements, be a State resident, and pay the required premium amount. The premium amounts vary depending upon the family's income from zero to $5 per child per month with a $15 per month family unit cap to $10 per child per month with a $28 per month family unit cap. A family who loses coverage under the Program due to an increase in income may purchase extended coverage through the Program for one year by paying the full premium costs.

In addition to creating a Health Insurance Program for Children, the General Assembly enacted a tax credit for taxpayers who purchase health insurance for their children to help bridge the gap between assisted health insurance costs under the Health Insurance Program and unassisted health insurance costs as a family begins earning too much income to qualify for the Program. The credit is not allowed for the reduced premiums paid under the Program; it is allowed for premiums paid to purchase extended coverage under the Program.

The amount of the credit differs depending upon the taxpayer's adjusted gross income, stated as a percentage of the applicable federal poverty level, based upon the taxpayer's family size. For purposes of the credit, a taxpayer's family size is the number of persons for

whom the taxpayer may deduct a personal exemption on the taxpayer's tax return. This qualification means that a non-custodial parent who pays health insurance premiums for a child will not qualify for the credit if the parent cannot claim the child as a dependent on the parent's return. Under federal law, the custodial parent is entitled to claim the child as a dependent on the parent's income tax return unless the custodial parent signs a written declaration that the parent will not claim the child as a dependent for that taxable year.

To prevent a double tax benefit, the tax credit may not be claimed if the amount paid by the taxpayer for insurance coverage is deducted from or not included in the taxpayer's gross income for income tax purposes. If a taxpayer claimed a deduction for health insurance costs of self-employed individuals for the taxable year, the amount of credit otherwise allowed is reduced by the amount of the deduction. In 1999, a self-employed individual may deduct 45% of health insurance costs from income tax. This percentage increases to 100% by the year 2007. If a taxpayer claims a deduction for medical care expenses, the taxpayer is not allowed a credit. Lastly, if a taxpayer uses "pre-tax" dollars to pay the health insurance premiums through a cafeteria plan, the taxpayer is not allowed a credit. Roughly 40% of the parents now paying health insurance premiums for their children do so with "pre-tax" dollars and, therefore, are not eligible for the credit.

The tax credit may not exceed the amount of health insurance premium the taxpayer paid during the taxable year that provided insurance coverage for the taxpayer's dependent children. However, the amount of the credit may exceed the amount of tax owed by the taxpayer. If the credit allowed exceeds the amount of tax imposed, the excess is refundable to the taxpayer. In computing the amount of tax against which multiple credits are allowed, nonrefundable credits are subtracted before refundable credits. This credit is North Carolina's first refundable tax credit. To claim the credit, approximately 20,000 families that do not currently have to file a State income tax return will have to file a tax return to receive this refundable credit. Many low income families do not currently file income tax returns because their personal exemptions and standard deductions exceed their tax liability.

The ability of the Department of Revenue to ensure compliance with this credit will be difficult. The Department does not currently require a taxpayer to include a copy of the taxpayer's federal return with the State return. However, the Department will need this information to ensure that the taxpayer did not claim a self-employed health insurance deduction or a medical expenses deduction for the premiums. The Department will probably require the federal return to be attached if the credit is claimed. How to determine whether premiums were paid with "pre-tax" dollars is more difficult since the wage and tax statement does not state whether health insurance premiums were paid with pre-tax dollars. To help the Department ensure compliance with the law, the act states the General Assembly's intent to appropriate funds to the Department for the 1999-2000 fiscal biennium to cover the costs of auditing 10% of the tax credits claimed for child health insurance premiums. The Department believes it will need 10 auditors and two clerical support positions to monitor 10% of the tax credits claimed.

S.L. 1998-22 (Senate Bill 1327, Senator Dalton)

AN ACT TO PRESERVE THE TAX-EXEMPT STATUS FOR PIPED NATURAL GAS SOLD BY MUNICIPALITIES, TO MAKE THE TAXES ON OTHER SALES OF PIPED NATURAL GAS MORE UNIFORM, TO ADJUST THE CITIES DISTRIBUTION OF THE TAX PROCEEDS UNTIL JUNE 30, 2000, TO DIRECT THE REVENUE LAWS STUDY COMMITTEE TO DETERMINE THE IMPACT OF

THE TAX ON THE DISTRIBUTION TO CITIES, AND TO DIRECT THE UTILITIES COMMISSION TO STUDY THE ISSUE OF TRANSPORTATION RATES.

This act combines the current gross receipts and sales taxes on piped natural gas into a single, per therm excise tax and applies the tax uniformly to all sales of piped natural gas not exempt from the tax, effective July 1, 1999. The act also preserves the tax-exempt status for piped natural gas sold by the eight municipalities that operate their own piped gas system, by exempting them from the excise tax. The act is expected to reduce General Fund revenues by about $3.6 million a year.

There are three types of sellers of piped natural gas: a utility company, a gas marketer, and a gas city. A utility company is a utility regulated by the Utilities Commission. A gas marketer is a person who sells piped natural gas but is not a regulated utility. Gas marketers use the pipeline infrastructure of the utilities to deliver the gas they sell and they pay a transportation charge to the utilities for this service.[1] Piped natural gas is increasingly sold by persons who are not utilities. A gas city is a city that operates its own piped gas system. Eight cities in the State have done this since at least the 1950s: Bessemer City, Greenville, Kings Mountain, Lexington, Monroe, Rocky Mount, Shelby, and Wilson.

Before enactment of this act, two taxes applied to piped natural gas, franchise gross receipts tax and sales tax. The applicability and rate of each tax varied depending upon both the identity of the seller and the identity of the consumer. The franchise gross receipts tax was imposed at the rate of 3.22% of the gross receipts derived by a utility from the business of furnishing piped natural gas.[2] The tax applied only to the receipts of a regulated utility. This gross receipts tax on piped natural gas was enacted in the 1920s, when only regulated utilities could sell piped natural gas. Federal and state regulation of the piped natural gas industry has changed. Now, persons who are not utilities are allowed to sell piped natural gas. The gross receipts tax was not extended to these new sellers, however. Thus, gas marketers and gas cities were not subject to the tax, except to the extent the tax was imposed on the transportation charges paid by gas marketers or was embedded in the price paid for gas bought from a utility for resale to customers.

A special sales tax of 3% also applied to utilities' retail sales of piped natural gas. This tax was imposed in 1985, when the General Assembly split the existing 6% franchise gross receipts tax into a 3% sales tax and a 3.22% gross receipts tax, to make the sales tax portion deductible by individuals on their federal income tax returns. Although the federal tax law changes in 1986 removed this deduction, North Carolina did not change its taxation of utilities. Like the franchise gross receipts tax, this special sales tax did not apply to sales by gas marketers or gas cities because, by its terms, it was limited to sales by utilities.

The act eliminates bifurcated taxation of piped natural gas and applies a uniform excise tax to all piped natural gas consumed in this State. The excise tax exempts gas distributed to or by a gas city but does not otherwise distinguish between sales by utilities and sales by others. The tax is due monthly and is payable, generally, by the company that delivers the gas to the

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[11] The act directs the Utilities Commission to study the transportation rates utilities charge for delivering gas from the interstate pipeline.

[2] If the general corporate franchise tax under G.S. 105-122 exceeded the franchise gross receipts tax under G.S. 105-116, the company was required to pay the excess as well. The same structure is retained under the new piped natural gas tax, which combines both the gross receipts tax and the sales tax, by requiring piped natural gas companies to pay the general corporate franchise tax but allowing them a credit against the tax equal to 50% of the new piped natural gas tax.

end-user. The tax rate is structured as a "declining block" that decreases as the amount of therms of piped gas consumed in a month increases.

A declining block tax rate is used to preserve the prior allocation of the tax burden among the three classes of piped gas customers: residential, business, and industrial. The sales and gross receipts taxes were a percentage of price; residential prices are the highest, business prices are in the middle, and industrial prices are the lowest. The combination of price and tax rate therefore resulted in a higher effective rate of tax on residential customers and a lower rate on business and industrial customers. The new tax preserves this differential in the burden by applying a lower tax rate to those who use higher volumes

The only sales tax exemption applicable to piped natural gas under prior law was the "products of the mine" exemption. Under that exemption, the sale of piped gas by the producer of the gas, in the producer's capacity as a producer, was exempt from sales and use tax. Few consumers of piped natural gas buy their gas directly from the producer. This act does not, therefore, retain this exemption in the new excise tax imposed in lieu of the franchise gross receipts tax and sales tax.

Under prior law, a percentage of the franchise gross receipts tax on piped natural gas service provided inside municipalities was distributed to the municipalities. This act preserves the distribution by providing that 50% of the new excise tax on piped gas service provided within a municipality will be distributed to that municipality. To minimize the difference between the former distribution amounts and the new distribution amounts, the tax provides that the amount distributed to cities will be adjusted for the first year, fiscal year 1999-2000. Any distribution adjustments will be made within the monies distributed to the cities. No State money is involved. The act directs the Revenue Laws Study Committee to look at the distribution formula and recommend to the General Assembly any changes it believes are necessary.

For several years before 1998, the Department of Revenue did not impose the general 4% State and 2% local sales and use tax on the sale of piped natural gas. However, upon reexamination of the law, the Department determined that piped natural gas is tangible personal property as that term is defined in the sales and use tax statutes and all sales of piped natural gas are, therefore, subject to tax. Based on this determination, therefore, all retail sales of piped natural gas would have become subject to the general sales and use tax effective July 1, 1998, if they had not been exempted by this act.

The sale of piped gas by a gas city or by a gas marketer would not have been exempt from sales and use tax. Therefore, the retail sale of piped gas by these sellers would have been subject to a 6% State and local sales and use tax unless a lower rate applied. The law provided a lower rate of 3% for all sales made by regulated utilities and a lower rate of 2.83% for sales made to farmers, manufacturers, and laundries. Piped natural gas taxed at the State rate of 3% or 2.83% was not subject to the 2% local sales and use tax. The use tax would have applied to a person who purchased piped natural gas from a seller who was not required to collect North Carolina sales tax.

S.L. 1998-24 (Senate Bill 124, Senator Odom)

AN ACT TO REDUCE THE WHITE GOODS DISPOSAL TAX RATE TO ONE RATE FOR ANY WHITE GOOD REGARDLESS OF WHETHER THE WHITE GOOD CONTAINS CHLOROFLUOROCARBONS, TO EXTEND THE WHITE GOODS DISPOSAL TAX SUNSET, TO ALTER THE DISTRIBUTION OF THE TAX PROCEEDS FROM THIS TAX, TO CLARIFY HOW THE COUNTIES MAY USE THE TAX PROCEEDS, AND TO LIMIT THE AMOUNT OF SURPLUS A

COUNTY MAY ACCUMULATE BY HOLDING FURTHER TAX DISTRIBUTIONS UNTIL THE SURPLUS IS REDUCED.

This act reduces the white goods tax rate, delays the sunset of the tax, changes the formula for distributing the tax proceeds, clarifies the purposes for which counties may use the proceeds of the tax, and provides for detailed reporting on counties' white goods management programs, effective July 1, 1998. The act also provides that counties that have excess tax proceeds may not receive additional distributions until they have spent the excess tax proceeds, effective January 1, 1999. The act does not affect the General Fund.

The white goods tax was imposed effective January 1, 1994. The purpose of the tax is to provide a source of revenue for the proper disposal of discarded white goods. A white good is a domestic or commercial large appliance, such as a refrigerator, a water heater, an air conditioner unit, or a dishwasher.

The white goods tax was scheduled to sunset July 1, 1998. This act extends the sunset three years, to July 1, 2001. The tax is a flat rate charged on every new white good purchased in this State or brought into this State for storage or use. The former tax rates were $10.00 for white goods that contain chlorofluorocarbon refrigerants and $5.00 for white goods that do not contain chlorofluorocarbon refrigerants[3]. This act reduces the tax to $3.00 per white good, whether or not it contains chlorofluorocarbon refrigerants.[4] The reduction of the tax rate will reduce revenues by about one-half.

Under prior law, the tax proceeds were distributed as follows: 5% to the Solid Waste Management Trust Fund[5], 20% to the White Goods Management Account[6], and 75% to counties on a per capita basis. This act changes the formula so that 8% of the tax proceeds will be distributed to the Solid Waste Management Trust Fund and 72% will be distributed to counties. The 20% allocation to the White Goods Management Account does not change.

Counties may use the white goods tax proceeds distributed to them only for the management of discarded white goods. This act clarifies that expenditures of the tax proceeds must be related directly to the management of discarded white goods. It also specifies that authorized uses include capital improvements for infrastructure to manage discarded white goods, operating costs associated with managing discarded white goods, and cleanup of illegal disposal sites that consist of more than 50% discarded white goods. If an illegal disposal site consists of 50% or less discarded white goods, the tax proceeds may be used only to clean up the discarded white goods portion of the site.

The act limits the amount of surplus white goods disposal tax proceeds that a county can accumulate. Counties receive their distributions of white goods tax proceeds on a quarterly basis. Effective January 1, 1999, this act provides that if, at the end of a fiscal year, the county has a surplus of white goods tax proceeds that equals or exceeds 25% of the amount it was

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[3] Chlorofluorocarbon refrigerant is a type of gas that must be removed from a white good under federal law.

[4] Chlorofluorocarbon refrigerants were banned by the federal Environmental Protection Agency as of January 1, 1996.

[5] The money in this Fund is used to fund activities of the Department of Environment and Natural Resources (DENR) to promote waste reduction and recycling, to fund research on the solid waste stream in North Carolina, to fund activities related to the development of secondary materials markets, to fund demonstration projects, and to fund research by in-State colleges and universities.

[6] The money in this Account is used to make grants to local governmental units to assist them in managing discarded white goods.

eligible to receive for the fiscal year, it may not receive additional distributions until its surplus falls below that level. The amount that would have been distributed to a county will instead be credited to the White Goods Management Account.

Counties submit an annual financial information report to the Local Government Commission. This act directs the Local Government Commission to require counties to include in the reports information about their management of white goods and their receipt and expenditure of white goods tax proceeds and related revenues. This requirement will make counties more accountable for their white goods management programs. The annual financial information report must be certified by the county finance officer based on an independent audit by a certified public accountant.

The Department of Environment and Natural Resources reports annually to the Environmental Review Commission on the management of white goods. This act requires the Department to provide this report to the Revenue Laws Study Committee as well, and to include in the report a summary of the information about counties' white goods management programs provided in their annual financial information reports to the Local Government Commission.

S.L. 1998-55 (Senate Bill 1569 , Senator Hoyle) Bill Lee Act Changes.

AN ACT (1) TO ALLOW CERTAIN RECYCLING FACILITIES AN INVESTMENT TAX CREDIT, A REFUNDABLE INCOME TAX CREDIT, A SALES TAX REDUCTION FOR CRANES AND MATERIALS HANDLING EQUIPMENT, A SALES TAX REFUND FOR CONSTRUCTION MATERIALS, A SALES TAX EXEMPTION FOR ELECTRICITY, AND A PROPERTY TAX EXEMPTION FOR RECYCLING PROPERTY; (2) TO ALLOW AIR COURIERS A SALES TAX REDUCTION FOR MATERIALS HANDLING EQUIPMENT USED AT A HUB, A SALES TAX EXEMPTION FOR AIRCRAFT LUBRICANTS AND PARTS USED AT A HUB, AND A PROPERTY TAX EXEMPTION FOR AIRCRAFT USED AT A HUB; (3) TO EXPAND THE INDUSTRIAL DEVELOPMENT FUND AND UTILITY ACCOUNT TO INCLUDE THE SAME BUSINESSES AS THE WILLIAM S. LEE ACT, TO EXPAND THE UTILITY ACCOUNT TO TIER TWO COUNTIES, TO RAISE THE MAXIMUM GRANT UNDER THE INDUSTRIAL DEVELOPMENT FUND, AND TO ALLOW LOCAL GOVERNMENTS TO USE PART OF THE INDUSTRIAL DEVELOPMENT FUND GRANT FUNDS TO ADMINISTER THE GRANT; (4) TO PROVIDE FOR THE DESIGNATION OF STATE DEVELOPMENT ZONES, TO PROVIDE A LOWER WAGE STANDARD, A HIGHER WORKER TRAINING CREDIT, A ZERO THRESHOLD FOR THE INVESTMENT TAX CREDIT, AND AN ADDITIONAL JOBS TAX CREDIT WITHIN ZONES, AND TO GIVE ZONES PRIORITY FOR COMMUNITY DEVELOPMENT BLOCK GRANTS; AND (5) TO AMEND THE WILLIAM S. LEE ACT BY EXPANDING THE CENTRAL ADMINISTRATIVE OFFICE CREDIT TO GROSS PREMIUMS TAXES AND TO JOBS CREATED BEFORE THE PROPERTY IS CONSTRUCTED, BY PROVIDING THAT THE INVESTMENT TAX CREDIT THRESHOLD APPLIES ONLY ONCE FOR A TWO-YEAR PROJECT, BY EXPANDING THE INVESTMENT TAX CREDIT TO OPERATING LEASES FOR PROJECTS OVER ONE HUNDRED FIFTY MILLION DOLLARS, BY EXPANDING THE RESEARCH AND DEVELOPMENT TAX CREDIT, BY SIMPLIFYING THE WORKER TRAINING TAX CREDIT, BY IMPOSING A FEE FOR INCENTIVE APPLICANTS, BY EXTENDING THE CREDIT CARRYFORWARD PERIOD FOR PROJECTS OVER ONE HUNDRED FIFTY MILLION DOLLARS, BY PROVIDING FOR A SINGLE TIER DESIGNATION FOR TWO-COUNTY INDUSTRIAL PARKS, BY CLARIFYING THAT CREDITS ARE ALLOWED FOR BUSINESSES THAT ARE SOLD ONLY IF THERE IS IMMINENT CLOSURE OR AN EMPLOYEE BUYOUT, BY CLARIFYING THE METHOD OF CALCULATING THE INVESTMENT TAX CREDIT FOR LEASES, AND BY CLARIFYING THE DEFINITIONS OF THE TYPES OF BUSINESSES ELIGIBLE FOR

INCENTIVES.

The act is designed to promote economic development throughout the State in five ways:

1. It makes various amendments to the William S. Lee Act to encourage large investments and remove technical problems with the Act.
2. It authorizes enhanced incentives for development zones, which are economically distressed areas located within municipalities.
3. It expands and modifies the Industrial Development Fund to provide financial support for projects in rural and less prosperous areas of the State.
4. It provides sales tax and property tax reductions for air couriers and provides a temporary bidding law exemption for specific projects of the Piedmont Triad Airport Authority to encourage development of air courier hubs.
5. It provides an investment tax credit for large and major recycling facilities that locate in Tier One counties to encourage development of a recycling industry in Tier One counties. In addition, it provides a refundable reinvestment credit and sales tax reductions for major recycling facilities.

The act is expected to reduce General Fund revenues by $2.22 million in fiscal year 1998-99, $1.21 million in fiscal year 1999-2000, $6.81 million in fiscal year 2000-01, $12.97 million in fiscal year 2001-02, and $16.33 million in fiscal year 2002-03.

William S. Lee Act Modifications.

Part I of the act makes a number of technical and substantive changes to the William S. Lee Quality Jobs and Business Expansion Act. Unless a different date is given, these changes all become effective beginning with the 1999 tax year. The William S. Lee Act, enacted by the General Assembly in 1996, extended the jobs tax credit to all 100 counties, enacted a new tax credit for worker training expenses, enacted a new tax credit for increasing research activities, and enacted two new tax credits for investing in machinery and equipment. In 1997, the General Assembly expanded the types of businesses eligible for the credits and created a new tax credit for taxpayers who purchase or lease real property to be used as central administrative office property.

The act makes two changes to the central administrative office credit that was enacted last year. First, it allows the credit to be taken against the insurance gross premiums tax. This change will permit insurance companies to qualify for the credit. Second, it clarifies that a central administrative office meets the requirements for creating new jobs if the jobs begin before the office property is in service but are located at a temporary facility that the business occupies while waiting for its office property to be completed.

It also makes two changes to the credit for investing in machinery and equipment. First, it provides that for projects that span two tax years, the threshold applies only once to the investment. Otherwise, a project put in service over several months within a calendar year would receive more benefit than a project put in service over several months starting in one calendar year and ending in the next. This change went into effect beginning with the 1998 tax year. Second, it expands the credit to include machinery and equipment the taxpayer uses under an operating lease, but only if the machinery and equipment are part of a project valued at $150 million or more.

The act expands the credit for research and development. This credit piggybacks the federal credit, allowing a State credit equal to approximately ¼ of the federal credit as it

relates to North Carolina activities. In 1997, Congress enacted an alternative credit for research and development. The act modifies the State credit to also allow a credit equal to approximately ¼ of the federal alternative credit as it relates to North Carolina activities.

The act simplifies the credit for worker training by replacing the credit measured by costs of training with a credit for wages paid to workers while they are being trained (not including on-the-job training). The credit is restricted to employees for whom the taxpayer qualifies for the jobs tax credit and employees being trained to operate machinery and equipment for which the taxpayer qualifies for the credit for investing in machinery and equipment. In order to qualify under former law for this credit, the taxpayer was required to get its planned training certified in advance by the Department of Community Colleges. This requirement was difficult both for taxpayers and for the Department of Community Colleges.

Finally, Part I of the act makes a number of administrative and technical changes to the William S. Lee Act. First, it levies a $75.00 application fee on taxpayers who seek to qualify for a credit. The proceeds of the fee will help the Department of Commerce defray its costs in administering the credits. This fee becomes effective January 1, 1999. Second, the act extends the credit carryforward period for investments over $150 million. The act provides that for large investments, the excess may be carried forward for up to 20 years (was five years). Third, the act clarifies that credits are allowed only for new and expanding businesses, not for existing businesses that are sold to another taxpayer. An exception is made for a business that has closed, has filed a federally required notice that closure is imminent, or has been purchased in an employee buyout. In these cases, the business will be able to qualify for the credits to the same extent as a new business. Fourth, the act provides that if an industrial park is located in and owned by two counties who both contribute significantly to its development, the industrial park as a whole is considered to have the tier designation of the lower-tiered county. This change promotes regional cooperation in industrial development and avoids an industrial zone that is split into two tier designations. Fifth, the act clarifies and renumbers the definitions of the different types of businesses that are eligible for credits[7] and clarifies the method of calculating the investment tax credit and the business tax credit for property acquired by a capital lease.

State Development Zones.

Part I of the act provides for the designation of economically distressed areas located within municipalities as State development zones and authorizes enhanced incentives for businesses that locate in a development zone, effective beginning with the 1999 tax year. The act defines a development zone as an area that meets all of the following conditions: (1) consists of one or more contiguous census tracts, block groups, or both, (2) has a population of 1,000 or more, at least 20% of whom are below the poverty level, and (3) is located at least

[7] The bill changes statutory references from the Standard Industrial Classifications (SIC) to the North American Industrial Classification System (NAICS) to conform to the federal system. These references are used in the William S. Lee act to define various types of businesses. The bill also changes the term "manufacturing and processing" to "manufacturing" and the term "warehousing and distribution" to "warehousing and wholesale trade" to conform to the NAICS. In April 1997, the United States Office of Management and Budget announced the adoption of a new industry classification replacing the SIC, a system used to classify most of the data we have about industries or kinds of business in our economy. The updating of industry classifications is nothing new. Since its origination in the 1930s, the SIC system has been revised or updated every 10 or 15 years to reflect new developments in the American economy and to address problems identified by data users and statistical agencies. It was last revised in 1987.

partly in a municipality with a population over 5,000. If a business locates in a development zone, the wage standard it has to meet is the same as for Tier One counties - slightly lower than the standard for other counties. In addition, if a business locates in a development zone, its maximum worker training credit is $1,000 rather than $500, it receives an additional $4,000 per job on its jobs tax credit, and there is no threshold for the credit for investing in machinery and equipment.

The Secretary of Commerce will designate development zones upon request of a taxpayer or a local government. The designation is effective for four years. The act provides that a development zone may qualify for priority in receiving community development block grants if the municipality's governing body adopts a strategy to improve the zone and establishes a committee to implement the strategy, in accordance with guidelines established by the Department of Commerce. The Department of Commerce is required to report annually to the Department of Revenue and the General Assembly's Fiscal Research Division on the number of new jobs created within development zones and percentage of those jobs that were filled by residents of those development zones.

Infrastructure Funds.

Part II of the act, effective July 1, 1998, states the intent of the General Assembly to appropriate funds to the Industrial Development Fund and the Utility Account of the Industrial Development Fund. The Governor's budget requested an appropriation of $18 million for the Fund and $14 million for the Utility Account. The Current Operations Appropriations and Capital Improvement Appropriations Act of 1998 provides nonrecurring funding of $1.5 million to the Utility Account for economic development grants for water and sewer infrastructure. Under prior law, money in the Utility Account could be used in Tier One counties for construction or improvements to new or existing water, sewer, gas, or electrical utility distribution lines or for existing, new, or proposed industrial buildings to be used in manufacturing and processing, warehousing and distribution, or data processing. The act expands the scope of the Utility Account to include Tier Two counties.

Under prior law, the Industrial Development Fund provided funding for manufacturing projects in Tier One, Two, and Three counties as well as in areas experiencing major economic dislocations. The funds could be used for equipment, capital improvements, and utility distribution lines. Projects in Tier Two and Three Counties were required to match the State funds on a $1/$3 basis. The funding was capped at $4,000 per job to be created and $400,000 per project. The act raises the per-job cap to $5,000 and the per-project cap to $500,000. The act also expands the industries covered by both the Industrial Development Fund and the Utility Account to include all of the following: manufacturing, central administrative offices, air courier services, data processing, and warehousing and wholesale trade.

Finally, Part II of the act amends the statute to allow local governments receiving industrial development funds to use up to 2% of these funds to verify that the funds are used as required by law and otherwise to administer the grant or loan.

Air Courier Hubs.

Part III of the act provides sales tax and property tax reductions for interstate air couriers in order to encourage the development of air courier hubs in North Carolina. An air courier is an air carrier that delivers individually addressed letters, parcels, and packages. Effective January 1, 2001, the act provides that sales to an interstate air courier of equipment for handling and storing materials at its hub will be subject to a reduced sales tax of 1%, capped at $80 per item. In addition, the act provides a sales tax exemption for sales to an

interstate air courier of aircraft lubricants, aircraft repair parts, and aircraft accessories for use at the air courier's hub in this State. Effective beginning with the 2001 property tax year, the act provides a property tax exemption for aircraft owned by an air courier and apportioned for property tax purposes to the courier's hub in this State. A hub is the place in this State where the air courier allocates for property tax purposes more than 60% of its North Carolina aircraft value and where its primary function is to receive packages from consolidation locations for sorting and distribution, rather than to consolidate packages for delivery to another airport for sorting and distribution.

Part III of the act also grants a bidding law exemption for the Piedmont Triad Airport Authority. The exemption is effective for a five-year period beginning January 1, 1999, and applies to design and construction of an air freight distribution facility on airport property, and related supplies, equipment, and services.

Recycling Facilities.

Part IV of the act provides tax incentives for "large" and "major" recycling facilities located in Tier One counties at the time of initial construction. A recycling facility is a plant that manufactures products, most of which are made from at least 50% post-consumer waste material. The facility also includes related infrastructure, buildings, and equipment on land near (and in the same county as) the plant. A large recycling facility is one that will involve at least $150 million in new investment and 155 new jobs within a two-year period. A major recycling facility is one that will involve at least $300 million in new investment and 250 new jobs within a four-year period. In order to qualify for the applicable tax incentives, the owner of the facility must obtain certification from the Department of Commerce that it will meet the minimum investment and new job requirements. If the facility fails to meet either requirement within the applicable time period, it forfeits any tax benefit it received as a result of being certified.

Part IV of the act provides an investment tax credit for both large and major recycling facilities, effective beginning with the 1998 tax year. This investment tax credit is in lieu of the investment tax credit provided in the William S. Lee Act. The recycling facility investment tax credit differs from the Lee Act credit in the following ways:

1. The Lee Act credit is equal to 7% of the cost of machinery and equipment, while the large recycling facility credit is equal to 20% of the cost and the major recycling facility credit is equal to 50% of the cost.
2. The credit is allowed at the time the owner of the recycling facility accrues expenses to purchase or lease machinery and equipment, rather than at the time machinery and equipment are placed in service, as under the Lee Act. If the facility fails to put the machinery and equipment in service within 30 months after taking the credit, the credit is forfeited and must be repaid.
3. The credit is allowed against both the corporate franchise tax and the corporate income tax. The Lee Act allows the credit against either but not both taxes.
4. The credit may equal 100% of the tax due from the owner of the facility. The Lee Act limits the credit to 50% of tax due.
5. The excess credit may be carried forward for 25 years. Under the Lee Act, as revised by this act, the relevant carryforward period would be 20 years.

Part IV of the act also provides to major recycling facilities locating in Tier One counties a refundable corporate income tax "credit for reinvestment", effective beginning with the 1998 tax year. The credit applies if the major recycling facility is not accessible by ocean barge or

ship and incurs additional expenses due to transporting its materials and products by alternative modes of transportation. The reinvestment credit is equal to the amount of these additional expenses, which must be documented annually to the Secretary of Commerce. The credit is subject to a dollar cap each year, in increasing amounts. In 1999, the cap is $640,000. In 2004, the cap levels off at $10.4 million a year. The act sunsets this reinvestment credit effective with the 2008 tax year. The act states the intent, however, to postpone the sunset if any major recycling facility can document that it is still experiencing additional expenses in 2008 due to its inability to use ocean barges or ships to transport materials and products.

The reinvestment credit is refundable. That means that if the amount of credit exceeds the major recycling facility's tax liability after all other credits are subtracted, the balance is paid out in cash. For the first ten years the reinvestment credit is in effect, a major recycling facility must use the amount received in credit to invest in rail and roads associated with the facility, in transportation infrastructure to reduce the expense of transporting materials and products to and from the facility, or in land and infrastructure for industrial sites, other than the facility itself, in the same county. If there are not enough reasonable opportunities for investments in those purposes in a given year, however, the major recycling facility may invest the amount of credit received in the facility itself, but only after it has made the minimum investment of $300 million required to qualify as a major recycling facility. The facility must document its compliance with this reinvestment requirement and it forfeits any part of the credit it spends for another purpose.

Part IV of the act provides several sales and use tax reductions for major recycling facilities located in Tier One counties, effective beginning July 1, 1998. First, it provides that a reduced sales tax rate of 1%, capped at $80 per item, applies to cranes, foundations, transportation equipment, and material handling equipment used at the major recycling facility. These items would otherwise be subject to 4% State sales tax and 2% local sales tax. Second, it exempts from sales tax lubricants and other additives for vehicles and machinery used at the plant, and other materials and supplies (not including machinery and equipment) that are used or consumed directly in the manufacturing process. These items would also otherwise be subject to a combined State and local rate of 6%. Third, it exempts from sales tax electricity purchased for use at the major recycling facility. This electricity would otherwise be subject to State sales tax at 3% or 2.83%. Fourth, it provides an annual sales tax refund for taxes a major recycling facility pays directly or indirectly on building materials, building supplies, fixtures, and equipment that become a part of the real property of the recycling facility located in a Tier One county.

Finally, Part IV of the act provides for major recycling facilities an expanded version of the existing property tax exemption for property used for recycling. Under general law, to qualify for exemption, the property must be used exclusively for recycling and have recycling as its primary purpose. Effective beginning with the 1999-2000 property tax year, the act provides that, for major recycling facilities only, the property must be used predominantly for recycling and have recycling as a purpose. The Department of Environment and Natural Resources determined that these changes would be necessary to prevent a major recycling facility from being disqualified because it adds fillers or other materials to the post-consumer waste material when manufacturing products.

S.L. 1998-67 (Senate Bill 186, Senator Foxx)

AN ACT TO PROVIDE THAT THE GOVERNING BODY OF A TAXING UNIT MAY DELAY THE ACCRUAL OF INTEREST ON CERTAIN UNPAID PROPERTY TAXES.

This act is a Statewide, public act that addresses a specific local problem concerning the payment of local property taxes for the 1997-98 fiscal year. The specific local problem is that after Gaston County conducted its octennial revaluation of property in 1997, 22,000 appeals were filed. This was many more appeals than had been anticipated. Although the statutory due date for the 1997 taxes was January 5, 1998, many of the appeals were still under consideration by the board of equalization and review at that time. Counties do not have the authority to release, refund, or compromise tax liabilities except as specifically provided by law.

This act allows the governing body of each affected taxing unit to adopt a resolution that waives interest on taxes paid between January 6, 1998, and March 7, 1998. The act is limited to taxing units whose tax receipts were not delivered to the tax collector before October 3, 1997. September 1 is the statutory due date for delivering tax receipts. The act applies to Gaston County and the units for which it collects taxes because the tax receipts were not delivered to the tax collector of Gaston County until October 3. Gaston County collects taxes for 13 of its 14 municipalities and for all of its 19 fire districts.

Generally, the law provides taxpayers two avenues to protest the amount of property tax due. A taxpayer may submit a written demand for a release of a tax claim any time prior to the payment of the tax. However, taxpayers who choose not to pay all or part of their taxes by the due date are subject to interest. Counties do not have the statutory authority to release taxpayers from the accruing interest, even if the taxpayers' appeals are under consideration. This is a rigid prohibition and failure to abide by it carries personal liability for each member of the board of commissioners. The rates of interest are 2% from January 6 to February 1 and ¾% for each month or part of a month after that. The second avenue to contest the payment of property tax is to pay the tax when due. If the tax is reduced on appeal, then the taxpayer receives a refund.

This act is a Statewide act rather than a local one because it must be Statewide to avoid conflicting with the prohibition in the North Carolina Constitution on certain local acts. Article II, section 24(1)(k) of the State Constitution prohibits local acts that extend the time for collecting taxes or otherwise relieve a tax collector from the performance of this duty. Although the act is nominally Statewide, it applies only to Gaston County because it applies only to units whose tax receipts were not delivered to the tax collector before October 3, 1997. Gaston County is the only taxing unit whose tax receipts were not delivered by that date. The General Assembly enacted a similar act for Beaufort County in 1995 and for Buncombe County in 1990.

S.L. 1998-69 (Senate Bill 1229, Senator Kerr)

AN ACT TO ABOLISH TAX WAIVERS FOR THE TRANSFER OR DELIVERANCE OF A DECEDENT'S PROPERTY.

This act repeals the provisions of the former inheritance tax law (which was itself repealed by S.L. 1998-212) that required an inheritance tax waiver before the property of a decedent could be transferred. The estate tax, known as the pick-up tax, which replaced the former inheritance tax effective January 1, 1999, has no inheritance tax waiver requirement. This act does not affect the General Fund.

Former law required that when a person died, the Department of Revenue had to be

notified of any accounts, stocks, and bonds in the name of the decedent and of the contents in the decedent's safe-deposit box. The Department would then issue inheritance tax waivers authorizing the bank or financial institution in possession of the decedent's property to transfer or release the property. Accounts held by the decedent and spouse with right of survivorship did not require a waiver before transfer.

This act repealed the inheritance tax waiver requirement and related penalties for failure to obtain waivers and forms required for the waivers, effective for decedents dying on or after August 1, 1998. The inheritance tax itself was repealed effective for decedents dying on or after January 1, 1999. This act was a recommendation of the Revenue Laws Study Committee.

S.L. 1998-95 (Senate Bill 1252, Senator Hoyle)

AN ACT TO SIMPLIFY AND MODIFY PRIVILEGE LICENSE AND EXCISE TAXES AND RELATED PERMIT FEES.

This act incorporates two bills that the Revenue Laws Study Committee recommended to the 1998 General Assembly: Senate Bill 1252 and House Bill 1320. Senate Bill 1252 made numerous changes to the State privilege license taxes on amusements, professionals, installment paper dealers, banks, and alcoholic beverages. House Bill 1320 reduced the current 3% gross receipts tax on motion pictures to 1%.

Amusements.

The former law imposed an annual $50 State privilege license tax and a 3% gross receipts tax on any form of entertainment not otherwise taxed or specifically exempted under Article 2 of Chapter 105 of the General Statutes. The State privilege license tax on amusements was treated as an advance payment of the corresponding gross receipts tax, and the license tax was applied as a credit upon the gross receipts tax. This act repeals the State privilege license taxes on amusements. Amusements will continue to pay a 3% gross receipts tax and any existing local license tax. This repeal simplifies the taxes assessed on amusements. It does not reduce revenues because the license tax was a credit against the gross receipts tax. This part of the act becomes effective July 1, 1999.

This act also reorganizes the list of amusements exempt from the tax so that all of the exemptions appear in one statute. The list includes those amusements that are currently exempt in Article 2, amusements that are listed as exempt in other sections of the statutes (the North Carolina Symphony Society and amusements organized under the Agriculture Chapter), and outdoor historical dramas that are described in Chapter 143 of the General Statutes and that have generally been exempt under the current definition for exemptions in G.S. 105-40. Exempt amusements set out in Article 2 are high school and elementary school athletic contests, teen centers, dances and amusements promoted and managed by a corporation that operates a center for the performing and visual arts when the dance or amusement is held at the center, and amusements on the Cherokee Indian reservation where the entity providing the amusement is authorized to do business on the reservation and pays the tribal gross receipts levy to the tribal council.

The act expands the exemption for elementary and secondary school dances and other amusements to include all such amusements. Former law exempted only the first $1,000 of gross receipts derived from dances and amusements actually promoted and managed by secondary schools when the proceeds were used exclusively for the school and not to defray expenses.

Motion Pictures.

The act imposes a lower rate of tax on one form of amusements: motion picture shows. The act imposes a 1% gross receipts tax on this form of amusement, effective October 1, 1998, as opposed to the 3% gross receipts tax imposed on other forms of amusements. A 1% gross receipts tax on movie admissions is expected to generate $1.5 million in General Fund revenue in fiscal year 1998-99.

The act clarifies that if a taxpayer offers an entertainment or amusement that includes both a motion picture and an entertainment or amusement that is subject to the 3% gross receipts tax, then the higher rate applies. The act also clarifies the exemption of motion pictures that are shown at a center for the performing and visual arts that is promoted and managed by an organization organized for religious, charitable, scientific, literary, or educational purposes. The showing of the motion picture show may not be the primary purpose of the center. North Carolina's policy of taxing movie concessions is consistent with other states and the District of Columbia.

Prior to July 1, 1997, the State imposed a privilege tax on motion picture shows. Motion picture shows were not subject to the 3% gross receipts tax imposed on other forms of entertainment or amusement because it does not apply to amusements "otherwise taxed". During the Second Extra Session of the 1996 Session, the General Assembly repealed a number of State privilege license taxes, including the privilege taxes on motion picture shows. When the privilege license tax was repealed, motion picture shows fell into the category of amusements not otherwise taxed and, therefore, became subject to the 3% gross receipts tax. The Department of Revenue chose not to assess this tax in fiscal year 1997-98 until the General Assembly clarified that the tax should be collected. The Department's uncertainty arose from the absence of debate by the 1996 General Assembly on the issue of imposing a gross receipts tax on movies.

The Revenue Laws Study Committee considered this issue at length and heard from several interested parties. The Committee learned that 27 states tax movie admissions in one fashion or another. Twenty-one states simply apply their sales tax to theater admissions. Alabama and Arkansas have a specific gross receipts tax on movie admissions, while Connecticut and South Carolina have a general admissions tax. Arizona has a transaction privilege tax on theaters and Indiana has a gross income tax on theaters. Twenty-five of these twenty-seven states have movie taxes higher than North Carolina's 3% gross receipts tax. Eleven of the states that tax movie admissions are members of the Southern Legislative Conference. After much debate, the Committee recommended imposing a 1% gross receipts tax on movies, as opposed to the 3% gross receipts tax imposed on other, similar forms of entertainment and amusements.

Professionals.

The act makes several clarifying and technical changes to the statewide privilege license tax on persons practicing certain professions or engaging in certain businesses. It also reorganizes the existing exemptions from the tax found throughout the statutes so that all exemptions will appear in one place. Lastly, it ends the practice of charging half the privilege license tax to an individual who applies after the midpoint of the fiscal year. This part of the act becomes effective July 1, 1999, and is expected to generate $14,375 in General Fund revenues in fiscal year 1999-2000.

The statute exempts persons age 75 and over and certain persons practicing the professional art of healing from the privilege license tax. The act adds to this list blind persons

engaging in a trade or profession as a sole proprietor. The exemption for blind persons was formerly set out in another section of Chapter 105, which this act repeals.

The act repeals an exemption from occupational license taxes for persons serving in the armed forces and replaces it with a general provision in Chapter 93B of the General Statutes that allows an individual who is serving in the armed forces of the U.S. an extension of time to pay any license fee charged by an occupational licensing board if the individual qualifies for the extension of time to file a tax return under G.S. 105-249.2. This statute provides that the Secretary of Revenue may not assess interest or penalty against a taxpayer for any period that is disregarded under section 7508 of the Internal Revenue Code in determining the taxpayer's liability for a federal tax. This section of the Internal Revenue Code postpones tax liability for an individual serving in the armed forces, or serving in support of the armed forces, in an area designated by the President as a "combat zone". The period of service in such an area, plus the period of continuous qualified hospitalization attributable to an injury received while serving in that area, and the next 180 days thereafter, are disregarded in determining tax liability. The provision belongs in the Occupational Licensing Chapter, as opposed to the Chapter on Taxation, because it relates to occupational licensing, not to taxes.

Installment Paper Dealers.

Installment paper dealers are persons engaged in the business of dealing in, buying, or discounting installment paper, notes, bonds, contracts, or evidences of debt, when at the time or in connection with the execution of these instruments, a lien is reserved or taken on personal property located in the State to secure the payment of the obligations. These dealers paid an annual $100 license tax and a quarterly tax of .275% of the total face value of the obligations within the preceding quarterly calendar months. This act repeals the $100 license tax and increases the quarterly tax of .275% to .277% to offset the loss of revenue from repealing the annual $100 license tax. According to the Department of Revenue, this increase in rate will cover $112,811 of the $123,800 loss. This provision becomes effective July 1, 1999.

Banks.

Under former law, banks were issued a privilege license each year and paid a tax at the rate of $30 for each $1,000,000, or fractional part thereof, of total assets held. These assets were determined by averaging the total assets shown in the four quarterly call reports of condition (consolidation domestic subsidiaries) for the preceding calendar year as required by bank regulatory authorities. This act eliminates the license and requires the banks to submit instead an annual report to the Department of Revenue showing the average of their total assets. The privilege tax must be paid with the report by July 1. The submission of a report in lieu of issuing an annual license will relieve the Department of having to issue licenses that vary yearly for each bank. The Department's computer system has had difficulty issuing licenses that vary each year, and this problem will become even more difficult with the year 2000 changeover. Also, a report will assist the Department in auditing banks.

The act also repeals the $100 annual privilege tax for banks that have been in operation for less than a year. New banks will be required instead to pay a tax on the average of the total assets determined by the number of days in operation. These changes related to banks become effective July 1, 1999, and are expected to generate $1,400 in General Fund revenues.

Alcoholic Beverages.

The act repeals annual privilege licenses on ABC permittees, raises the ABC permit fees by the corresponding amounts, and simplifies the tax rate on malt beverages. This part of the act becomes effective May 1, 1999, and is not expected to affect General Fund Revenues.

Under former law, a person had to obtain both a permit issued by the ABC Commission and a corresponding annual State license issued by the Department of Revenue to engage in a business involving alcoholic beverages. The person had to obtain the ABC permit before applying for the license. Upon payment of the State license tax, issuance of the license was mandatory if the applicant had the corresponding ABC permit. The information and qualifications required for the annual State license were the same as the information and qualifications required for the corresponding one-time ABC permit. The additional State license served no purpose other than to raise revenue. The act repeals these privilege licenses in order to eliminate the duplicate requirement of applying for a State privilege license and a corresponding ABC permit. The approximately $3.1 million revenue loss from the repeal of these privilege licenses is offset by an increase in the ABC permit fees set out in G.S. 18B-902(d), by repeal of the reduced fees for combined permits in G.S. 18B-902(e), and by an increase in the annual renewal fees for mixed beverage and guest room cabinet permits in G.S. 18B-903(b).

The act also simplifies the filing requirements for malt beverage taxpayers by setting a single rate of excise tax on malt beverages. Formerly, an excise tax of 48.387 cents per gallon was assessed against malt beverages in barrels holding at least 7¾ gallons and an excise tax of 53.376 cents per gallon was assessed against malt beverages in cans, bottles, barrels, or other containers holding less than 7¾ gallons. The act imposes an excise tax of 53.177 cents per gallon on the sale of any malt beverage, regardless of the container. Thus, the act simplifies the filing and reporting requirements for malt beverages by eliminating the requirement that vendors of these products specify the size and type of containers sold in their monthly reports to the Secretary.

S.L. 1998-96 (Senate Bill 1001, Senator Cochrane)

AN ACT TO PROVIDE AN AMUSEMENTS TAX EXEMPTION FOR CERTAIN NONPROFIT ARTS ORGANIZATIONS AND COMMUNITY FESTIVALS.

The State levies a 3% gross receipts privilege license tax on anyone engaged in the business of offering amusements, athletic events, dances, and entertainments for which an admission is charged. This act creates two new, narrow exemptions from this privilege license tax for nonprofit arts festivals and community festivals that meet certain conditions. The act applies to events such as "First Night" of Raleigh and the Azalea Festival of Wilmington. The act became effective August 14, 1998. The Department of Revenue estimates that the revenue loss to the General Fund will be less than $25,000 a year.

Under the act, an arts festival is exempt from the privilege license tax if the person holding the festival meets all of the following conditions:

- The person holds no more than two festivals a year.
- Each of the festivals lasts no more than seven days.
- The arts festivals are held outdoors on public property and involve a variety of exhibitions, entertainments, and activities.

- The person is exempt from State income tax.

Under the act, a community festival is exempt from the privilege license tax if the person holding the festival meets all of the following conditions:

- The person holds no more than one community festival a year.
- The festival lasts no more than 7 days.
- The festival involves a variety of exhibitions, entertainments, and activities, the majority of which are held outdoors and are open to the public.
- The person is exempt from State income tax.

S.L. 1998-98 (Senate Bill 1226, Senator Cochrane)

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

This act makes numerous technical and clarifying changes to the revenue laws and related statutes as recommended by the Revenue Laws Study Committee. The following table provides a section-by-section analysis of the changes:

Section	Explanation
1	Recodifies the corporate income and franchise taxes on savings institutions. These entities currently pay tax under Article 8D of Chapter 105 of the General Statutes. The taxes are identical to the income and franchise taxes paid by other corporations, with two adjustments. This section moves the taxation of savings institutions from Article 8D to the regular corporate income and franchise taxes in Articles 3 and 4. The two adjustments are retained. In addition, a general exemption in Article 8D has been transferred to the relevant privilege tax statutes: G.S. 105-83, G.S. 105-88, and G.S. 105-102.3. This technical change was reviewed and approved by the Bankers Association, which represents savings institutions.
2 - 3	Repeals obsolete provisions of the inheritance tax.
4	Conforms cross-reference to corporate tax credits to reflect that some credits are in other Articles of the Revenue Act.
5 - 8	Makes conforming changes to Subchapter S Corporation law to reflect the fact that trusts may now be shareholders.
9	Repeals an individual income tax definition for a term that is no longer used in the individual income tax law.
10	Adds cross-reference to two individual income tax credits that do not apply to estates and trusts.
11	Corrects grammar.
12 - 13	Clarifies that withholding is not required on payments to tax-exempt entities.
13.1	Removes cross-references to soft drink excise tax, which has been repealed effective July 1, 1999.

13.2 Removes reference to type of payment for food purchased under the Food Stamp Program, because counties are beginning to use a system in which a type of credit card will be used in lieu of food stamps or coupons.

14 Removes references to sales tax applying to two types of motor fuel for which motor fuel tax refunds are allowed, because refunds are not made on these types of motor fuel (accidental mixes and fuel sold to marinas).

With respect to accidental mixes, the sales and use tax applies when they are later reblended. If there is an accidental mix of dyed diesel fuel with tax-paid motor fuel, a refund of the excise tax is allowed. The product is then blended back in with dyed diesel stock and a resale is made for purposes of off-highway use or home heating and sales tax is charged. If there is an accidental mix of gasoline with diesel fuel, this mix has to be rerefined. It cannot be used in its current state because it is so highly combustible. If there is an accidental mix of undyed diesel fuel with dyed kerosene, then you reblend it with dyed kerosene, resell it, and sales tax is paid at resale.

14.1 Removes reference to type of payment for food purchased under the Food Stamp Program, because counties are beginning to use a system in which a type of credit card will be used in lieu of food stamps or coupons.

15 Modifies the definition of interstate carrier for purposes of sales tax refunds to reflect the deregulation of the industry.

15.1 Makes a conforming change to reflect a change under the Equitable Distribution Laws that now provides for the distribution of marital property and divisible property.

16 Provides that a gift tax return is not required for gifts that are exempt from tax: gifts to charity and gifts between spouses. The 1997 federal tax act made a similar change to the federal gift tax, which formerly required returns for gifts to charity above $10,000.

17 Removes incorrect language describing the calculation of the gross premiums tax.

18 Clarifies insurance company tax exemption language. G.S. 105-228.10 was enacted in 1945 to provide that local governments may not levy additional taxes on insurers and other entities subject to the gross premiums tax. This section rewrites the statute to state that cities and counties are prohibited from levying a privilege license tax or a gross premiums tax on entities subject to gross premiums tax. The vague language of the statute is rewritten to clarify that insurance companies are not exempt from local sales taxes, local meals taxes, and other similar taxes that the General Assembly has authorized for local governments since this statute was enacted in 1945. Insurance companies currently pay these taxes and the terms of the tax statutes make it clear that they are not exempt.

19 Deletes an individual income tax exemption that is no longer needed because federal law exempts the same income and our law piggybacks the federal law.

20 Provides that tax information may be shared on a reciprocal basis with tax officials from jurisdictions outside the United States, as required by the International Fuel Tax Agreement.

21	Clarifies that taxpayers may rely upon all interpretations published by the Department of Revenue to the same extent as provided under current law only for specified types of interpretations.
22 - 24	Remove ambiguities in the use value property tax law that were created unintentionally when these statutes were rewritten and reorganized in 1995. The rewrite created potential, although strained, interpretations that deferred taxes were no longer required to be paid in some or in many cases where the law has always intended for them to be paid. These sections clarify that the law with respect to "rollback" of deferred taxes was not restricted by the 1995 rewrite. They also make further clarifying changes to the language.
25	Revises definition of public service company to reflect deregulation of carriers and to conform to Institute of Government interpretation that regulation requirement applies only to catch-all category of "any other company performing a public service."
26 - 27	Repeal two property tax provisions that have expired.
28	Clarifies that motor fuel sold to the federal government is exempt only if sold for use by the federal government.
29	Repeals a provision allowing refunds for motor fuel tax paid by marinas. Federal law no longer requires marinas to pay tax on motor fuel they purchase, so refunds are no longer necessary.
30	Corrects an incorrect cross-reference.
30.1	Removes reference to type of payment for food purchased under the Food Stamp Program, because counties are beginning to use a system in which a type of credit card will be used in lieu of food stamps or coupons.
31 - 32	Deletes provisions that have expired.
33 - 35	Corrects incorrect term describing short-term rental vehicles.
36	Reenacts a law modifying historic rehabilitation tax credits. The law was not roll called. Although the law expands the credits, in certain instances it could postpone part of the tax benefit allowed under prior law.
37	Repeals an obsolete tax on consigned candy products.
38	Amends the Setoff Debt Collection Act to reflect the new names given to public assistance programs by the 1997 welfare reform legislation, and to remove excess verbiage that resulted from a redlining error.
39	Conforms the structure of the Revenue Laws Study Committee statute to fit the requirements of the General Assembly's new computer system, and corrects gender-specific language.
40	Repeals list of cross-references to Highway Bond Acts. The list is incomplete and serves no purpose.
41 - 54	Change from "Division" to "Part" the name of the subdivisions within Articles of Chapter 105 of the General Statutes, in order to be consistent with all other General Statutes. The new computer statutory database software will function better with consistent nomenclature.

55 - 67	Eliminate the term "Schedule" used as an additional name for Articles in Chapter 105 of the General Statutes, in order to be consistent with all other General Statutes. The new computer statutory database software will function better with consistent nomenclature.
68 - 113	Change cross-references to "Divisions" and "Schedules" to "Parts" and "Articles," respectively.
114	Provides that the act is effective when it becomes law, August 6, 1998.

S.L. 1998-100 (House Bill 1422, Representative C. Wilson)

AN ACT TO REMOVE UNCONSTITUTIONAL RESTRICTIONS ON INDIVIDUAL INCOME TAX CREDITS FOR CHILD CARE AND FOR CONSTRUCTING DWELLINGS FOR THE HANDICAPPED.

This act amends two individual income tax credits to remove restrictions that prevent nonresidents from taking the credits. These restrictions are probably unconstitutional in light of a recent United States Supreme Court case. The act is effective for taxable years beginning on or after January 1, 1998. Its impact upon the General Fund is expected to be no more than $600,000 a year. This act is a recommendation of the Revenue Laws Study Committee.

On January 21, 1998, the United States Supreme Court held in Lunding v. New York that a state's tax laws must treat nonresidents on terms of 'substantial equality' with residents. The Court found that New York's individual income tax could not deny the alimony deduction to nonresidents while granting it to residents. The Court concluded that while the Privileges and Immunities Clause of the United States Constitution affords states considerable discretion in formulating their income tax laws, there must be a substantial reason for the difference in treatment of residents and nonresidents within a tax structure.

North Carolina has two individual income tax credits that only residents could claim: the credit for construction of dwelling units for handicapped persons and the credit for child care and certain employment-related expenses. As discussed below, there does not appear to be any reason, much less a substantial one, for prohibiting nonresidents from taking either credit. It appears, therefore, that the part of each credit limiting it to residents would likely have been ruled unconstitutional if challenged. This act removes the restriction of the construction credit to residents, and modifies the child care credit so that a nonresident may take a proportional amount of the credit based on the percentage of his or her income that is taxable to North Carolina.

G.S. 105-151.1 grants an individual income tax credit for construction of multi-family rental units that conform with mandatory building code requirements related to accessibility by the handicapped. The dwelling units must be located in North Carolina. The credit was limited to North Carolina residents. The residence of the owner bears no relation to the benefit to this State of having handicapped-accessible dwellings constructed. Furthermore, the same credit is allowed under the corporate income tax law, but without any restriction based on the residence or domicile of the taxpayer that constructs the dwelling units.

G.S. 105-151.11 grants an individual income tax credit for child care or similar expenses incurred so the taxpayer may be gainfully employed. The credit was not allowed to nonresidents. For nonresidents employed in North Carolina, the expenses would be directly related to the taxpayer's North Carolina income and thus there seems to be a substantial reason

that the credit should be allowed rather than disallowed. In any case, legislative history of this credit shows that the provision preventing nonresidents from claiming the credit was retained in the law due to an oversight in 1981, when it should have been repealed.

The tax credit for child care expenses was formerly a deduction. On July 9, 1981, the General Assembly repealed the deduction and replaced it with a credit. At that time, nonresidents were not allowed to take income tax deductions that were not directly connected to their North Carolina income. Thus, in changing the deduction to a credit, the General Assembly retained the rule that nonresidents could not take advantage of the tax benefit. A few months later, however, the General Assembly abandoned its policy of disallowing nonresidents' deductions for expenses unrelated to North Carolina income and enacted a new law allowing a nonresident to take a proportional amount of these deductions. Through an oversight, the restriction that had been carried forward from the child care deduction to the child care credit was not similarly modified. Because this restriction remained in the law only because of an oversight, a court would have been unlikely to find the required substantial reason for it to be upheld in a constitutional challenge.

S.L. 1998-121 (House Bill 1367, Representative Hill)

AN ACT TO RAISE THE SALES TAX QUARTERLY THRESHOLD AND TO REPEAL THE ANNUAL WHOLESALE SALES TAX LICENSE.

This act makes three changes to the sales tax law, as recommended by the Revenue Laws Study Committee:

- It raises the sales tax quarterly threshold from $50 to $100, effective July 1, 1999.
- It repeals the annual wholesale sales tax license, effective July 1, 1998.
- It changes the name of the retail sales tax license to certificate of registration.

The act is expected to reduce General Fund revenues by about $1.3 million a year. It will also cause a one-time shift of about $2 million from the 1999-2000 fiscal year to the 2000-01 fiscal year.

Taxpayers that are consistently liable for at least $20,000 a month in State and local sales and use taxes must file sales and use tax returns and remit taxes on a semimonthly basis. Under prior law, taxpayers that were liable for less than $50.00 a month in State and local sales and use taxes could file returns and remit the sales and use taxes owed on a quarterly basis. All other taxpayers would file returns and remit taxes on a monthly basis.

Section 1 of this act increases the sales tax quarterly threshold from $50 to $100, effective July 1, 1999. This change means that approximately 10,000 taxpayers that are now filing monthly sales and use tax returns will be able to file quarterly returns. The change will reduce the number of returns currently being filed by one-third. The threshold was last increased in 1991 from $25 to $50. This change in the law will mean that approximately $2 million that would have been collected in fiscal year 1999-2000 will not be collected until fiscal year 2000-01 because two months of collections are shifted into the 2000-01 fiscal year.

Under prior law, a wholesale merchant was required to obtain both a wholesale sales tax license and a certificate of registration, referred to in the statute as a retail sales tax license. The form for the two licenses was the same and the information necessary to obtain both of these licenses was the same. The only difference was that the wholesale sales tax license was

an annual license that costs $25. The certificate of registration needs to be acquired only once and costs $15.

Section 2 of this act repeals the wholesale sales tax license, effective July 1, 1998. The Department of Revenue does not need the information from this license because the wholesale merchant has already provided the Department with the information it needs on the certificate of registration. The tax is also expensive to collect and document and is a nuisance tax for wholesale businesses to report and pay.

Section 3 rewrites the law to clarify that both wholesale merchants and retailers must obtain a certificate of registration before beginning business. Although the statute refers to the certificate as a "retail sales tax license", it must be obtained by both wholesale merchants and retailers because a privilege tax is imposed on both of them under the sales and use tax article. The act changes the name of the license to a "certificate of registration" because that more accurately reflects the nature of the document. It also corresponds to the name it is most commonly known as in the business community: a "Merchant's Certificate of Registration".

Unlike the annual wholesale sales tax license, the certificate of registration needs to be obtained only once. It is valid unless it is revoked because the retailer or wholesale merchant fails to comply with the sales and use tax law. In the case of a retailer, the certificate becomes void if the retailer does not make any sales for a period of 18 months. If the certificate is revoked or becomes void, the retailer or wholesale merchant must register with the Department and obtain a new certificate of registration before engaging in business.

S.L. 1998-132 (Senate Bill 1354, Senator Kerr)

AN ACT TO AUTHORIZE THE ISSUANCE OF GENERAL OBLIGATION BONDS OF THE STATE, SUBJECT TO A VOTE OF THE QUALIFIED VOTERS OF THE STATE, TO ADDRESS STATEWIDE CRITICAL INFRASTRUCTURE NEEDS BY PROVIDING FUNDS (1) FOR GRANTS AND LOANS TO LOCAL GOVERNMENT UNITS FOR WATER SUPPLY SYSTEMS, WASTEWATER COLLECTION SYSTEMS, WASTEWATER TREATMENT WORKS, AND WATER CONSERVATION AND WATER REUSE PROJECTS AND (2) FOR GRANTS, LOANS, OR OTHER FINANCING TO PUBLIC OR PRIVATE ENTITIES FOR CONSTRUCTION OF NATURAL GAS FACILITIES.

The act, known as the "Clean Water and Natural Gas Critical Needs Bond Act of 1998", authorizes the issuance of general obligation bonds in the amount of $1 billion. The issuance of these bonds, $800 million for water and sewer bonds and $200 million for natural gas bonds, was approved by a majority of the voters in the November 1998 election. The act also increases the maximum principal amount of revolving loans and grants that may be made to local government units from the funds in the Clean Water Revolving Loan and Grant Fund. The maximum principal amount of grants made to any one local government unit during any fiscal year is increased from $1 million to $3 million. Finally, the act establishes a 19-member State Infrastructure Council within the Department of Environment and Natural Resources (DENR). The purpose of the Council is to develop a State strategic plan that addresses the State's water supply and distribution and wastewater treatment needs.

Use of Clean Water Bond and note proceeds.

The act provides for the issuance of $800 million of Clean Water Bonds. Public necessity and specific criteria listed in the act for various allocations of the Clean Water Bonds are the primary considerations in granting and loaning these proceeds. In addition, special emphasis is placed on the creation of efficient water supply and wastewater collection and disposal

systems, sound fiscal policies, creative planning, efficient operation and management, development of a capital improvement plan, compliance with watershed protection requirements, and use of proceeds to address current critical infrastructure needs.[8] None of the Clean Water Bond proceeds may be used for a low-pressure pipe wastewater system or for construction of a new water and sewer line to provide water and sewer connection in a designated watershed area.[9]

$500 million of the proceeds of the Clean Water Bonds are to be issued as follows:

- $330 million are to be used by DENR to provide high-unit cost grants to local government units. These grants are for the purpose of paying the cost of water supply systems, wastewater collection systems and wastewater treatment works, water conservation projects, water reuse projects, and rural school water or wastewater projects. In order for a high-unit water supply or wastewater project to be eligible for a grant, the project must require estimated average household water and sewer user fees greater than 1 ½% of the median household income in the local government unit in which the project is located. S.L. 1998-212, enacted October 30, 1998, clarifies the statutory criteria used to determine eligibility of an applicant for a high-unit cost grant for a wastewater or water supply project. The amended definition clarifies that if an applicant is constructing its first utility or has only a single utility and is upgrading that utility, then the applicant's eligibility is determined by comparing the project's debt service, operation, and maintenance costs to ¾% of the median household income in the local government unit. The requirement that a project's debt service, operation, and maintenance cost be compared to 1 ½% of the median household income applies only when the applicant has two utilities (water and sewer).
- $35 million are to be used by DENR to provide State matching funds for federal wastewater or water supply funds.
- $20 million are to be awarded and administered by the Department of Commerce for the purpose of making grants to local government units to pay the cost of clean water projects in connection with the location of industry to, and expansion of industry, in the State. These grants may be made only for projects that are located in economically distressed counties, that will have a favorable impact on the State's clean water objectives, and that deal with manufacturing and warehousing and wholesale trade.
- $60 million are to be awarded and administered by the Rural Economic Development Center as supplemental and capacity grants to eligible local government units. Eligibility criteria include the requirement that an applicant be a rural county, a local government unit in a rural county, or a county applying for a grant on behalf of a rural school. Projects located within economically distressed counties receive priority. A grant awarded to a rural county that is not an economically distressed county must be matched by the county on a dollar-for-dollar basis.

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[8] These special emphases do not apply to the allocation of $35 million of Clean Water Bonds for State matching funds or the allocation of $20 million of Clean Water Bonds for economic development.

[9] These prohibitions on the use of Clean Water Bonds do not apply to the allocation of $35 million of Clean Water Bonds for State matching funds.

- $55 million are to used for grants to local government units that are unsewered communities, that have a population of 5,000 persons or less, and that have a median household income that does not exceed 90% of the national median household income. To be eligible for a grant, a local government unit must agree to adopt a fee schedule that reflects at least the average annual water and wastewater cost per household calculated at 1 ½% of the median household income in the unit's jurisdiction. S.L. 1998-212, enacted October 30, 1998, clarifies that a local government unit that is constructing its first utility or that has only a single utility and is upgrading that utility, is eligible for these grants if it agrees to adopt a fee schedule that reflects at least the average annual water or wastewater cost per household calculated at ¾% of the median household income in the applicant's jurisdiction. These grants are to be awarded and administered by the Rural Economic Development Center. The act defines unsewered communities as "lacking centralized publicly owned wastewater collection systems and wastewater treatment works."

The remaining $300 million of the $800 Clean Water Bonds are to be used to provide loans to local government units to pay the cost of water supply systems, water conservation projects, water reuse projects, wastewater collection systems, and wastewater treatment works. A county may also apply for a loan for one of these projects on behalf of a rural school located in the county. DENR is to set the priorities for the loans. DENR and the Local Government Commission determine the eligibility of local government units for these loans. Each loan applicant must demonstrate its financial capacity to repay the loan and agree to adopt and effect a schedule of fees and charges that will provide for proper operation, maintenance, and administration of the projects.

Use of Natural Gas Bond and note proceeds.

The act provides that $200 million of Natural Gas Bonds are to be used for the purpose of providing grants, loans, or other financing to natural gas local distribution companies, persons seeking natural gas distribution franchises, State or local government agencies, or other entities for construction of natural gas facilities in unserved areas of the State. The following 22 counties are currently unserved: Alleghany, Ashe, Camden, Carteret, Cherokee, Chowan, Clay, Currituck, Dare, Gates, Graham, Hyde, Jackson, Jones, Madison, Pamlico, Pasquotank, Pender, Perquimans, Swain, Tyrrell, and Washington.

Reports required.

The entities making grants or loans under the act must file a yearly report with the Joint Legislative Commission on Governmental Operations and the Fiscal Research Division. Each report must show the allocation and making of loans or grants authorized by the act for the preceding fiscal year. Entities making the grants must also monitor compliance with the statutory goals for participation in projects by minority businesses and report to the General Assembly annually regarding minority business participation.

S.L. 1998-134 (House Bill 1617, Representative Mitchell)

AN ACT TO EXTEND THE INCOME TAX CREDIT FOR POULTRY COMPOSTING FACILITIES TO CORPORATE ENTITIES AND TO REMOVE THE SUNSET FOR THE INDIVIDUAL INCOME TAX CREDIT.

This act removes the sunset from the individual income tax credit for constructing a poultry composting facility in this State for composting poultry carcasses resulting from

commercial poultry operations. The credit would otherwise have expired in the 1998 tax year. The individual income tax credit was available only to individuals, shareholders in Subchapter S corporations, and other individual owners of pass-through entities. This act expands the credit to C corporations. The act is expected to reduce General Fund revenues by approximately $30,000 a year.

The amount of the credit allowed is 25% of the installation, equipment, and materials costs of building the facility, not to exceed $1,000. The credit does not apply to costs paid with funds provided to the taxpayer by a State or federal agency. The amount of the credit allowed cannot exceed the amount of tax imposed for the taxable year and any unused credit may not be carried forward to succeeding taxable years.

A poultry composting facility is a structure or an enclosure in which whole, unprocessed poultry carcasses are decomposed by a natural process into an organic, biologically safe byproduct that can be used for plant food. Every person engaged in raising poultry for commercial purposes who has a flock of at least 200 fowl is required to dispose of the poultry carcasses in a pit, an incinerator, or a poultry composting facility that has been approved by the Department of Agriculture. In the poultry business, the grower of a bird is often not the owner of the bird. The burden of disposing of poultry carcasses is usually on the grower of the bird.

The purpose of the credit is to encourage people who raise turkeys, chickens, or other poultry to compost the dead poultry rather than burn it or put it in a pit. By composting the poultry carcasses, the by-product can be converted into a useful product.

S.L. 1998-139 (House Bill 1489, Representative Neely)

AN ACT TO IMPROVE COLLECTION OF LOCAL TAXES BY ALLOWING CERTAIN GOVERNMENT OFFICIALS TO SHARE SPECIFIED TAX INFORMATION AND BY ALLOWING A TAXPAYER TO RECEIVE A RELEASE OR REFUND OF PRORATED VEHICLE PROPERTY TAXES IF THE TAXPAYER MOVES OUT-OF-STATE.

This act makes three changes relating to local taxes. The changes, which became effective September 14, 1998, relate to sharing of certain tax information and to property taxation of motor vehicles. First, the act authorizes the Department of Revenue and county tax officials to share information about the taxes paid on leased vehicles with each other and with a regional public transportation authority or a regional transportation authority. Second, it authorizes State tax officials to share information regarding sales and use taxes with city and county government representatives. Third, it also gives counties the specific authority to release or refund the taxes on a motor vehicle when the taxpayer moves out of state and surrenders his or her license plate. This last change was recommended by the Revenue Laws Study Committee.

Information sharing of taxes on leased vehicles by the Department of Revenue.

The Department of Revenue collects the alternate highway use tax, which is a gross receipts tax on vehicle rentals. Regional transit authorities are authorized to levy gross receipts taxes on vehicle rentals. The act provides an exception to G.S. 105-259, which prohibits the Department of Revenue from revealing confidential tax information. The act authorizes the Department of Revenue to provide regional transit authorities, on an annual basis, identifying information about the retailers from whom it collects the State vehicle rental tax. The compliance

and audit information gathered by the Department of Revenue in collecting the State vehicle rental tax will assist regional authorities in enforcing their local vehicle rental taxes.

In 1997, the General Assembly enacted S.L. 1997-417, which authorized a regional transit authority to levy a gross receipts tax of up to 5% on retailers within the region engaged in the business of renting passenger motor vehicles and motorcycles. The tax applies only to short-term rentals, i.e., rentals for a period of less than one year. The tax is collected by the authority but is otherwise administered in the same way as the optional highway use tax on gross receipts from vehicle rentals. This optional highway use tax is 8% on short-term rentals, so the combined tax within the jurisdiction of the authority would be 13% if the authority levies the full 5%. Each authority may use the proceeds of the tax for its public transportation purposes. Before levying or increasing the tax, the authority must obtain approval from each county in the region.

A regional transit authority is a regional public transportation authority created under Article 26 of Chapter 160A of the General Statutes or a regional transportation authority created under Article 27 of Chapter 160A of the General Statutes. The authority created under Article 26 is the Triangle Transit Authority for Wake, Durham, and Orange Counties. Article 27 authorizes the creation of a regional transit authority for the Triad region. The counties served by the Authority would be Forsyth, Guilford, Randolph, Davidson, and Alamance. The four major cities involved in the Authority's creation are Greensboro, High Point, Winston-Salem, and Burlington.

Information sharing of sales and use taxes by the Department of Revenue.

The Department of Revenue also collects sales and use taxes from retailers, including restaurants and other businesses that sell prepared food and beverages. Several local governments are authorized to levy local taxes on prepared food and beverages. They are Charlotte/Mecklenburg, Cumberland County, Dare County, Wake County, and the Town of Hillsborough. The act authorizes the Department of Revenue to provide counties and cities, on an annual basis, identifying information about the retailers from whom it collects sales and use taxes who might be engaged in the business of selling prepared food and beverages. This sharing of information will assist local governments in enforcing their local taxes on prepared food and beverages.

Information sharing of taxes by counties and regional transit authorities.

Some counties audit vehicle rental dealers for property tax purposes and audit retailers of prepared food and beverages for purposes of the local meals tax. G.S. 153A-148.1, however, prohibits counties from sharing tax information about a taxpayer's income or receipts. This information could assist regional transit authorities in enforcing their vehicle rental taxes and could assist the State in enforcing the sales and use tax it collects. The act adds two exceptions to the statute so that counties and regional transit authorities may (1) exchange tax information about vehicle rental dealers with one another when the exchange will aid either agency in fulfilling its duties, and (2) provide tax information to the Department of Revenue when the information will help the Department in its duties.

Property Taxation of Motor Vehicles.

Since 1993, counties have taxed motor vehicles that are registered with the Division of Motor Vehicles (DMV) on a revolving, year-round basis. If the taxes remain unpaid for more than four months after they become due, the county places a block on the vehicle's registration with DMV. This block provides an incentive for taxpayers to pay the taxes. The block has no

impact on a taxpayer who has moved out of the State during the tax year. In most instances the taxpayer is willing to pay the taxes on the part of the tax year that the vehicle was registered in North Carolina but does not want to pay the entire year's taxes. In the past, some counties have prorated the amount of taxes due in order to obtain part of the tax liability, although they did not have the statutory authority to do so. The act provides that authority, by requiring the partial release or refund of property taxes on a motor vehicle when the taxpayer surrenders the vehicle's registration plate to the DMV because the taxpayer has moved out of state and registered the vehicle in another jurisdiction. The taxpayer may apply for a release or refund of taxes on the vehicle for any full calendar months remaining in the vehicle's tax year after the date of surrender.

S.L. 1998-146 (Senate Bill 1230, Senator Kerr)

AN ACT TO CLARIFY THE TAXATION OF KEROSENE AND TO MAKE OTHER CHANGES IN THE MOTOR FUEL TAX LAWS.

This act makes changes in several different areas of the motor fuel tax laws that needed addressing. It clarifies the taxation of kerosene, provides automatic refunds to motor carriers, imposes a penalty for improper reporting, and makes several clarifying and conforming changes to the motor fuel tax laws.

As a means to address motor fuel tax evasion, the federal government in 1994 began requiring motor fuel to be dyed if it was non-tax-paid fuel. North Carolina passed a similar act in 1994. Under federal and State law, it is unlawful to use dyed diesel fuel in a vehicle used on the highway because the dye indicates that fuel taxes have not been paid on that fuel. Effective July 1, 1998, the federal government began requiring kerosene to be dyed. This act conforms North Carolina's law with the federal law by amending the definition of the term "diesel fuel" to include kerosene. This change makes it a State violation, as well as a federal violation, to use dyed kerosene for a highway use.

This change in the law also means that undyed kerosene will be taxed at the rack. Prior to July 1, 1998, the taxation of kerosene occurred when it was blended with other fuel to be used for highway purposes. This part of the act applies to kerosene sold on or after July 1, 1998. To help the Department of Revenue track the path of kerosene that had been removed from the terminal transfer system prior to July 1, 1998, the act required retailers, distributors, importers, and suppliers who had kerosene on hand or in their possession as of 12:01 a.m. on July 1, 1998, to inventory the kerosene and report the results of the inventory to the Secretary of Revenue by July 15, 1998. Originally, the legislation required these people to pay tax on this kerosene. The act, however, does not require the tax to be paid, but it does require the inventory to be made and submitted to the Department of Revenue.

The act makes conforming changes to the motor fuel tax laws to provide the proper exemptions from, and refunds of, the excise tax on motor fuels for undyed kerosene used for non-highway purposes. It adds diesel fuel that is kerosene and that is sold to an airport to the list of fuels exempt from the motor fuels tax. It provides that a distributor will be allowed to obtain a refund of the tax paid on kerosene when it is sold to an end user for heating if the kerosene is dispensed into the end user's storage facility that contains fuel used only for heating. It also provides that a distributor will be allowed to obtain a refund of the tax paid on the kerosene when it is sold to a retailer for non-highway use if the kerosene is dispensed into a storage facility marked for non-highway use and the storage facility is equipped with a

dispensing device that is not suitable to fuel highway vehicles. The act clarifies that kerosene sold for a non-highway use is subject to sales tax.

Effective July 1, 1998, the act provides for an automatic refund to a motor carrier whose credit exceeds its tax liability. A carrier operating in this State is taxed on the amount of motor fuel the carrier used in the State and is entitled to a credit for the motor fuels tax it paid on purchases made in this State. Under former law, a carrier had two years to request a refund when its tax credits exceeded its tax liability. If the motor carrier failed to request a refund within two years of tax payment, then the Department of Revenue kept the overpayment. From 1990 to 1996, the Department earned $6 million or approximately $83,300 per quarter from lapsed refunds. Since the complete implementation of the International Fuel Tax Agreement in 1996, motor carriers have been more aggressive in seeking refunds owed to them. Based on a review of the second quarter of 1997, the amount of lapsed refunds was down to $60,000. Under this act, carriers will automatically receive refunds and the Highway Fund will no longer receive $240,000 in unanticipated revenues from lapsed refunds each year.

Effective January 1, 1999, the act imposes a penalty on a licensed distributor or licensed importer who deducts an exempt sale when paying the excise tax to a supplier and then fails to report the exempt sale when filing a reconciling return. The amount of the penalty is $250.00. The Department of Revenue anticipates a revenue gain from this penalty, but it cannot estimate the amount.

The act also makes the following changes to the motor fuel tax laws. With the exception of the first change listed below, the changes became effective when the act became law, September 18, 1998:

- It expands the definition of "two-party exchange" to include sales between suppliers to address buy-sell agreements. This change is effective for transactions occurring on or after January 1, 1999.
- It requires a carrier who denies liability for a penalty to pay the penalty under protest and then apply to the Department for a hearing.
- It gives the Secretary of Revenue the authority to send a letter of release instead of returning a bond when a license holder files a bond or irrevocable letter of credit as a replacement for a previously filed bond or letter of credit and the license holder has paid all taxes and penalties due. The Secretary already has this authority under G.S. 105-449.76 when a license is canceled.
- It creates a presumption that <u>all</u> fuel delivered to a storage facility marked for non-highway use was used for highway purposes and is therefore subject to tax **if** the Secretary determines that a bulk-end user or retailer used or sold <u>any</u> of the untaxed dyed diesel fuel from that storage facility to operate a highway vehicle. This presumption currently applies to alternative fuels in G.S. 105-449.138(b).
- It clarifies the due date for applications for refunds of the motor fuel tax.
- It requires an applicant for a license to engage in the alternative fuel business to be incorporated, organized, or formed in this State or authorized to transact business in this State. If the applicant is an individual or a general partnership, the applicant must designate an agent for service of process in this State. An applicant for a license to engage in the motor fuel business must already meet this requirement.

S.L. 1998-158 (Senate Bill 1242, Senator Hoyle)

AN ACT TO PROVIDE FOR A WIRELESS ENHANCED 911 SYSTEM FOR THE USE OF CELLULAR, PERSONAL COMMUNICATIONS SERVICE, AND OTHER WIRELESS TELEPHONE CUSTOMERS, AS RECOMMENDED BY THE JOINT LEGISLATIVE UTILITY REVIEW COMMITTEE, AND TO ALLOW STATE AGENCIES TO LEASE PUBLIC PROPERTY FOR THE CONSTRUCTION OF WIRELESS COMMUNICATIONS TOWERS AND TO ENCOURAGE CO-LOCATION OF SERVICES TO THOSE TOWERS, AND TO MAKE A TECHNICAL CORRECTION TO G.S. 62A-10.

This act establishes a system for charging cellular telephone users for enhanced 911 service and establishes a method of administering and distributing the funds collected. An enhanced 911 system is one that provides cellular users with 911 service, directs wireless 911 calls to the appropriate dispatch agency based on where the calls originate, and enables the dispatch agency to determine the location and telephone number of the caller.

The service charges authorized by the act went into effect October 1, 1998. The revenues will be used to reimburse cellular service providers and 911 dispatch agencies for their costs in establishing federally required wireless enhanced 911 systems. Thus, the act does not affect the General Fund.

The act creates a thirteen-member Wireless 911 Board that will determine the service charge to be levied on cellular telephone users for wireless enhanced 911 service, aggregate the charges collected, and distribute them for purposes of paying for these systems. The Board is apparently a State entity; it is chaired by the Secretary of Commerce.

The initial service charge is 80¢ per month. The Board may adjust the rate every two years to a rate that will ensure full cost recovery by cellular service providers and 911 dispatch agencies over a reasonable period of time. The charge cannot exceed 80¢ per month.

Cellular service providers will collect the monthly service charge from their customers and may deduct 1% of the amounts collected as reimbursement for administrative expenses. The funds are to be deposited with the State Treasurer within 30 days after the end of each month. The Board will distribute these funds, and may retain 1% for administrative expenses. The act clarifies that the service charges are not considered taxable gross receipts or taxable income to the cellular service providers that collect them.

Sixty percent of the funds may be used to reimburse cellular service providers for complying with federal wireless 911 requirements, including design, upgrade, purchasing, leasing, programming, installing, testing, and maintaining of hardware and software components and data necessary to operate the system. Forty percent will be distributed to the agencies that receive incoming 911 calls and make the dispatches. Half of this 40% is distributed on a pro rata basis and the other half is distributed on the basis of population served. Dispatch agencies may use the funds only for the direct costs of establishing and maintaining a wireless enhanced 911 system. The act establishes audit and reporting requirements to assure that the funds are used only in accordance with law.

In 1996 and 1997, the Federal Communications Commission adopted orders intended to foster major improvements in the quality and reliability of 911 services available to customers of cellular service providers. The orders directed cellular service providers to adopt systems that automatically inform 911 dispatch agencies of the location and telephone number of cellular 911 callers. The FCC orders indicated that this requirement applies only if the system is requested by the 911 dispatch agencies, the dispatch agencies have made the necessary

investment in equipment to receive the information, and a cost recovery mechanism is in place. This act provides the necessary cost recovery system.

S.L. 1998-162 (House Bill 1318, Representative Neely)

AN ACT TO LIMIT THE NONRESIDENT WITHHOLDING REQUIREMENT TO ATHLETES AND ENTERTAINERS, TO INCREASE THE THRESHOLD REQUIREMENT FOR NONRESIDENT WITHHOLDING, AND TO PROVIDE A MECHANISM TO ENHANCE COLLECTION OF TAXES FROM NONRESIDENTS ENGAGED IN CONSTRUCTION-RELATED BUSINESSES.

This act limits the withholding requirement for payments to nonresident contractors so that it applies only to payments to contractors doing business as athletes and entertainers. It clarifies that radio programs, like television and film programs, are a form of entertainment for purposes of the withholding requirement. It also limits the requirement to payments to a nonresident contractor in excess of $1,500 a year. These changes relating to withholding become effective retroactively as of January 1, 1998. Originally, the withholding requirement also applied to construction-related trades. Although this act removes construction-related trades from the income tax withholding requirements, it does require occupational licensing boards for construction-related trades to cooperate with the Department of Revenue to assure that nonresidents pay delinquent taxes before being licensed to do business in this State. Most of these changes affecting occupational licensing become effective July 1, 1999. The changes made by this act are expected to reduce General Fund revenues by $7 million a year.

Many nonresidents who derive income from North Carolina do not pay the North Carolina tax due on this income. To address this collection problem, the 1997 General Assembly enacted S.L. 1997-109 to require payers to withhold 4% from the compensation paid to nonresident individuals and nonresident entities for personal services performed in North Carolina if the compensation exceeded $600 in the calendar year. The nonresident withholding requirement was suggested by the Department of Revenue and recommended to the 1997 General Assembly by the Revenue Laws Study Committee. The withholding requirement was phased in as follows: beginning January 1, 1998, it applied to payments to individuals for any personal services and payments to entities for services relating to entertainment, athletic events, and construction; it was to be expanded to payments to entities for all personal services effective January 1, 1999.

After S.L. 1997-109 became law, legislators, staff, and the Department of Revenue were contacted by businesses that were required to withhold from their payments for personal services. These businesses stated that the withholding requirement would create an expensive, time-consuming burden on them. They would have to reprogram their accounting software, examine invoices manually, and make difficult judgment calls regarding where services were performed. Large, multistate corporations in particular claimed that the new law would be burdensome. In response to these concerns, the Revenue Laws Study Committee recommended this act, which repeals nearly the entire withholding requirement. The only part that it retains is the requirement to withhold from payments for services relating to entertainment and athletic events.

As enacted by S.L. 1997-109, the withholding requirement applied to payments made to nonresident contractors only if the total payments exceeded $600 during a calendar year. The $600 threshold is the federal threshold for tax reporting under section 6041 of the Internal Revenue Code. This act raises the threshold for withholding from contract payments to nonresident athletes and entertainers from $600 to $1,500 a year. The higher threshold will

have the effect of insulating organizations, such as PTAs, from having to withhold on their occasional payments to out-of-state entertainers.

The rollback of the withholding requirement becomes effective retroactively as of January 1, 1998. Anyone who had been complying with the law by withholding for services other than those performed by athletes and entertainers could choose to refund the withheld taxes only if the taxes had not yet been paid into the Department of Revenue. All taxpayers who had taxes withheld from their payments will receive a credit for the withheld taxes when they file their income tax return.

The rationale for limiting the withholding requirement to athletes and entertainers is that athletic and entertainment events can be easily identified by those required to withhold, the entire performance is clearly taxable to the state where it occurs, and, because of the large sums often involved, the administrative burden of withholding is small compared to the benefit the State receives. For other personal services performed by nonresidents, the burden of compliance outweighs the benefit because the services are less easily identified and may be performed partly in this state and partly in another state. For those, such as large, multistate corporations, who deal with a myriad of contractors for goods and services throughout the nation, the burden can be significant.

The act also adds reporting and licensing requirements for nonresident individuals and foreign entities that seek occupational licenses for construction-related occupations. These changes affect four occupational licensing boards:

1. The State Licensing Board for General Contractors
2. The State Board of Examiners of Plumbing, Heating, and Fire Sprinkler Contractors
3. The State Board of Examiners of Electrical Contractors
4. The North Carolina State Board of Examiners for Engineers and Surveyors.

The act provides that each of these licensing boards must require a nonresident corporation or a nonresident limited liability company to first obtain a certificate of authority from the Secretary of State before being licensed by the board to do business or, in the case of engineers and surveyors, before having their certificate of licensure renewed. This requirement would become effective July 1, 1999. General law requires all foreign corporations and foreign limited liability companies to obtain a certificate of authority from the Secretary of State before transacting business in this State. G.S. 55-15-01, G.S. 57C-7-02.

The act also provides a mechanism to prevent nonresident individuals and foreign entities from renewing their occupational licenses if they (or one of their partners or members, in the case of a partnership or limited liability company) owe a delinquent income tax debt. A delinquent income tax debt is a final debt after the taxpayer has been notified of the final assessment and no longer has the right to contest the amount. The provisions relating to individuals go into effect July 1, 1999. The provisions relating to entities go into effect July 1, 2000.

If requested by the Secretary of Revenue, each construction-related licensing board will provide the Secretary of Revenue annual lists identifying the name, address, and tax identification number of every nonresident individual and foreign entity licensed by the board. Occupational licensing boards are already required to obtain individual licensees' social security numbers under G.S. 93B-14. The Department of Revenue will check these lists against its records of taxpayers who owe delinquent income tax debts. If the Department of Revenue finds that a nonresident individual or a foreign corporation owes a delinquent tax debt, the

Department will instruct the licensing board not to renew the taxpayer's license until the debt has been settled. If the Department of Revenue finds that a partner in a foreign partnership or a member of a foreign limited liability company owes a delinquent tax debt, the Department will instruct the licensing board not to renew the partnership or limited liability company's license until the debt has been settled. The license may be renewed once the licensing board receives written notice from the Secretary of Revenue that the debt has been settled.

This provision is similar to G.S. 93B-13, which revokes an occupational license if the licensee fails to comply with child support requirements. The provision is also similar to the law regarding property taxes on motor vehicles. The Division of Motor Vehicles provides the counties periodic lists of motor vehicles registered and renewed in this State. If the owner fails to pay local property taxes on the vehicle, the county notifies DMV not to renew the vehicle registration until the taxes are paid. This mechanism provides an incentive for taxpayers to pay their taxes.

Section 8 of the act clarifies that taxpayers are not entitled to an additional administrative hearing regarding a board's refusal to renew a license based on a delinquent income tax debt. The Department of Revenue will block renewals only for those debts for which the taxpayer has already been afforded full procedural rights required by the Due Process Clause of the United States Constitution.

S.L. 1998-171 (House Bill 1326, Representative Gray)

AN ACT TO UPDATE THE REFERENCE TO THE INTERNAL REVENUE CODE USED IN DEFINING AND DETERMINING CERTAIN STATE TAX PROVISIONS, TO EXTEND THE CORPORATE INCOME TAX CARRY FORWARD FOR NET ECONOMIC LOSSES, TO CONFORM TO FEDERAL GIFT TAX TREATMENT OF CONTRIBUTIONS TO QUALIFIED TUITION PROGRAMS, AND TO CORRECT TWO REDLINING ERRORS IN 1998 TAX LEGISLATION.

This act makes the following changes relating to tax law:

1. Upon recommendation of the Revenue Laws Study Committee, it rewrites the definition of the Internal Revenue Code used in State tax statutes to change the reference date from January 1, 1997, to September 1, 1998.
2. It conforms North Carolina tax law to the federal gift tax treatment of qualified tuition programs for taxable years beginning on or after January 1, 1998.
3. It extends the carryforward period for corporate net economic losses from five years to 15 years, effective for taxable years beginning on or after January 1, 1999, with a three-year cap on the amount of the extended losses that may be deducted.

Update Code Reference.

Updating the Internal Revenue Code reference makes recent amendments to the Code applicable to the State to the extent that State law previously tracked federal law. This update generally has the greatest effect on State corporate and individual income taxes because these taxes are based on federal taxable income and are therefore closely tied to federal law. Congress made numerous, significant changes to the Code in 1997 that will affect taxable income. Other changes to the Code were made by the Internal Revenue Service Restructuring and Reform Act of 1998. Because the State corporate and individual income taxes are based upon federal taxable income, these changes affect State policies and revenues.

The act provides that the recent federal tax changes that could increase a taxpayer's North Carolina taxable income for the 1997 tax year will not become effective until January 1, 1998. Under Article 1, Section 16 of the North Carolina Constitution, the General Assembly cannot pass a law that will increase a tax retroactively. There are a number of provisions in the federal Taxpayer Relief Act of 1997 and the Internal Revenue Service Structuring and Reform Act of 1998 that could increase taxable income for the 1997 tax year. Because the Code Update could not be acted upon until the 1998 Session of the General Assembly, these changes had to be given a delayed effective date.

The Code Update is expected to reduce General Fund revenues by $6.97 million in fiscal year 1998-99, $4.01 million in fiscal year 1999-2000, $10.70 million in fiscal year 2000-01, $18.53 million in fiscal year 2001-02, and $33.64 million in fiscal year 2002-03.

The following list summarizes some of the more significant changes to the Code:

1. Repeals the former rules on rollover and one-time exclusion for capital gains on the sale of a taxpayer's principal residence and replaces them with an exclusion of $250,000 ($500,000 for joint filers) of capital gain from the sale of a residence occupied by a taxpayer as a principal residence for two of the previous five years.
2. Expands the business expense deduction for self-employed individuals' health insurance to a percentage of 50% effective in 2000. The percentage is then phased up reaching 100% in 2007.
3. Establishes Roth IRAs effective for tax years beginning on or after 1/1/98, which allow nondeductible contributions of up to $2,000 of compensation (limited for those with adjusted gross income above a certain amount).
4. Expands existing IRAs by increasing the income limits and allowing an IRA for the spouse of a disqualified active participant, effective for taxable years beginning on or after 1/1/98.
5. Provides an income tax exemption for the annual earnings on amounts contributed to qualified tuition programs, such as North Carolina's Parental Savings Trust Fund, for the future payment of room or board at an institution of higher education. (Since North Carolina law already exempted these earnings, the North Carolina exemption is repealed because the law will automatically piggyback the federal exemption.)

Since the State corporate income tax was changed to a percentage of federal taxable income in 1967, the reference date to the Internal Revenue Code has been updated periodically. In discussing bills to update the Code reference, the question frequently arises as to why the statutes refer to the Code on a particular date instead of referring to the Code and any future amendments to it, thereby eliminating the necessity of bills like this. The answer to the question lies in both a policy decision and a potential legal restraint.

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

Secondly, and more importantly, however, the North Carolina Constitution imposes an obstacle to a statute that automatically adopts any changes in federal tax law. Section 2(1) of Article V 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 the 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."

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

Qualified Tuition Plan Gift Tax.

The act adopts for North Carolina gift tax purposes the provisions of federal law listed below. Conforming to federal law will relieve taxpayers from unexpected gift tax liability and will simplify tax compliance and administration.

1. A distribution from a qualified tuition program is not a taxable gift, unless a new beneficiary, who is a generation below the original beneficiary, is named to the account or receives the account in a rollover.
2. A contribution to a qualified tuition program is a gift to the designated beneficiary, but not a gift of a future interest. If the contribution were considered a gift of a future interest, a gift tax return would have to be filed even if the amount were under the $10,000 annual exclusion amount.
3. A contribution to a qualified tuition program is not a direct payment of tuition. If it were, it would be exempt from gift tax.
4. If a contribution exceeds the $10,000 annual gift tax exclusion amount, the donor may elect to avoid gift tax by treating the contribution as if it had been made over a five-year period. For example, a $25,000 contribution would not be taxable because it would be considered a gift of $5,000 a year over five years and thus would be below the $10,000 annual exclusion amount. These provisions apply to any qualified state tuition program under section 529 of the Internal Revenue Code. North Carolina's Parental Savings Trust Fund is such a program.

Corporate Loss Carryforwards.

The act extends the corporate income tax carryforward for net economic loss deductions from five years to 15 years, effective beginning with the 1999 tax year. Losses from 1993 and later tax years will benefit from this extension. For the first three years this extension is in effect, the carryforward deduction for losses more than five years old is restricted to 15% of taxable income. Beginning with the 2002 tax year, there will be no cap on the deduction for losses carried forward. A net economic loss is the amount by which a corporation's deductions for a taxable year exceed its income from all sources, including income not taxable by the State. Income not taxable includes income items that are deductible in determining State net income as well as a multi-state corporation's nonbusiness income that is allocable to another state.

The carryforward period for the similar net operating loss deduction under the Internal Revenue Code was recently extended from 15 to 20 years, but most states allow no more than a fifteen-year carryforward period. Because it may be difficult for an auditor to substantiate

a loss carryforward based on deductions that are ten to fifteen years old, the act clarifies that the corporation must maintain records that verify the amount of the loss deduction claimed and also provides that the taxpayer or the Secretary of Revenue may redetermine an item for a tax year that is closed under the statute of limitations in order to calculate a loss carried forward to an open year. The net economic loss carryforward is expected to reduce General Fund revenues by $3.70 million for each fiscal year beginning fiscal year 1999-2000 and ending fiscal year 2001-02. The reduction for fiscal year 2002-03 and thereafter will be $16 million a year.

S.L. 1998-178 (Senate Bill 1228, Senator Dalton)

AN ACT TO ENHANCE THE CRIMINAL PROVISIONS FOR TAX VIOLATIONS.

This act increases the criminal penalties for willful tax evasion and for aiding and abetting tax evasion, effective December 1, 1998. The act was recommended by the Revenue Laws Study Committee.

Before 1995, a person who willfully attempted to evade paying the amount of tax due, or who willfully helped another taxpayer attempt to evade paying the amount of tax due, could be punished by an active prison sentence, a monetary fine, or both. Effective January 1, 1995, however, a person who committed these crimes could be punished only by a monetary fine. In some cases, the amount of tax money involved is quite large. In others, the deception is egregious. Some of the people charged with these crimes are charged with them repeatedly.

The Criminal Investigations Division of the Department of Revenue informed the General Assembly that punishment by fine only is not sufficient to deter many would-be tax evaders. For this reason, the Division recommended changing the classification of these two crimes from a Class I felony to a Class H felony, so that a sentencing judge would have the discretion to sentence defendants to active time if the circumstances justify such a punishment.

The act changes the nature of the offense for attempting to evade a tax and for attempting to help another evade a tax from a Class I felony to a Class H felony. For Class I felonies, a sentencing judge is limited to imposing a fine unless the person has been convicted of the crime several times. For Class H felonies, a sentencing judge may impose not only a fine, but also an active sentence for first-time offenders if it is justified. Unless otherwise stated, the amount of the fine is left to the discretion of the court. In order to give a sentencing judge more latitude, the act also deletes the tax statutes' cap on the fine that may be imposed for these offenses.

S.L. 1998-183 (House Bill 20, Representative McMahan)

AN ACT TO INCREASE TO SEVEN PERCENT THE INCOME TAX CREDIT FOR CHARITABLE CONTRIBUTIONS BY NONITEMIZERS.

This act increases the individual income tax credit for charitable contributions by nonitemizers, in order to provide an additional incentive for charitable giving. It increases the amount of the credit from 2.75% to 7% of eligible contributions, effective beginning with the 1999 tax year. The act is expected to reduce General Fund revenues by almost $8 million a year.

Under the federal Internal Revenue Code, an individual who itemizes deductions may deduct contributions to nonprofit charitable organizations. Individuals who elect the standard

deduction, however, may not deduct charitable contributions. An individual's North Carolina's income tax is based on the federal calculation of taxable income, with some adjustments. The federal disallowance of charitable deductions for nonitemizers is "piggybacked" by North Carolina tax law. Legislation was introduced in Congress in 1996 to allow nonitemizers to deduct charitable contributions, but it did not pass.

Individuals who elect the standard deduction are those whose total itemized deductions (such as mortgage interest, State and local property and income taxes, medical expenses, and charitable contributions) do not exceed the standard deduction amount. The federal standard deduction amounts for 1997 are $6,900 for a married couple filing a joint return and $4,150 for a single individual.

In 1996, the General Assembly enacted G.S. 105-151.26, which allows a North Carolina income tax credit for 2.75% of a nonitemizer's charitable contributions to the extent the contributions exceed 2% of the taxpayer's adjusted gross income. A tax credit is a dollar-for-dollar subtraction from tax rather than a subtraction from taxable income. Thus, if a taxpayer pays tax at the 7% rate, a 7% tax credit is equal to a full deduction. North Carolina's tax rates are 6%, 7%, and 7.75%. By raising the credit from 2.75% to 7%, this act would make the credit equivalent to the deduction currently enjoyed by most itemizers.

The House Select Committee on Nonprofits recommended a 7% nonitemizers tax credit to the 1996 General Assembly, but the percentage was reduced in the course of the legislative session. This act raises the credit to the level originally proposed. In the course of its study, the Committee on Nonprofits considered whether tax incentives make a difference in charitable giving. It learned that federal tax incentives do but state tax incentives probably do not because the state tax is so small that it does little to influence individual giving. However, the Committee believed that a state incentive may affect perceptions, and thus behavior, even if the tax reduction is too small to provide a significant economic incentive.

S.L. 1998-186 (Senate Bill 1150, Senator Dalton)

AN ACT TO DELAY THE SUNSET OF THE REQUIREMENT THAT COUNTIES USE PART OF THE TWO HALF-CENT LOCAL SALES TAX PROCEEDS ONLY FOR PUBLIC SCHOOL CAPITAL OUTLAY PURPOSES.

This act, based on a recommendation of the Education Oversight Committee, extends the period of time during which counties must use part of their local sales tax proceeds for public school capital outlay purposes. The act does not affect General Fund revenues.

There are three Articles of the Revenue Act that authorize counties to levy local sales and use taxes. Article 39 authorizes a one-cent tax, Article 40 authorizes a half-cent tax, and Article 42 authorizes an additional half-cent tax. Article 40 and Article 42 provide that the county is required to use a percentage of the tax revenue for public school capital outlay purposes, including retirement of outstanding debt. The earmarking in Article 40, enacted in 1983, was for the first ten fiscal years the tax was in effect and the earmarking in Article 42, enacted in 1986, was for the first eleven years that the tax was in effect. In 1993, the earmarking was extended for an additional five years for both Articles. Most counties enacted the first half-cent tax under Article 40 in 1983, so its 15 years' earmarking would have expired in 1998; most counties enacted the second half-cent tax under Article 42 in 1986, so its 16 years' earmarking would have expired in 2002.

This act extends the time periods under Articles 40 and 42 by 13 years and 9 years, respectively, so that the earmarking will continue to the year 2011. For these additional years, counties will be required to use 30% of the tax revenue from the first half-cent local sales tax (Article 40) and 60% of the tax revenue from the second half-cent local sales tax (Article 42) only for public school capital outlay purposes. In 1985, the General Assembly exempted Burke County from the restriction that it use a percentage of the first half-cent local sales tax for public school capital outlay purposes. This exemption will remain in effect.

If a county can demonstrate that it does not need the earmarked revenue to meet its public school capital needs, it may petition the Local Government Commission to authorize it to use the money for any public purposes. In making its decision, the Commission must consider not only the public school capital needs but also the other capital needs of the county.

This act also defines public school capital outlay purposes as the term is defined in the School Budget and Fiscal Control Act. The term is defined broadly in that act to include appropriations for the acquisition of real property and buildings for school purposes as well as the acquisition of furniture, computers, equipment, buses, etc. The Local Government Commission currently interprets the term as it is defined in the School Budget and Fiscal Control Act. Therefore, this clarification of the law will not change the way counties are currently using the money.

S.L. 1998-197 (House Bill 1126, Representative Miner)

AN ACT TO EXEMPT LOCAL PAY PHONE SERVICES FROM SALES TAX.

This act exempts from sales tax pay telephone calls that are paid for by coin, effective January 1, 2000. Credit card calls and other calls not paid for by coin would not be exempt. The sales tax exemption allowed by this act is expected to reduce General Fund revenues by approximately $2 million annually. The gross receipts from sales of all local telecommunications services are subject to State sales tax at 3% (G.S. 105-164.4(a)(4a)) and State gross receipts tax at 3.22% (G.S. 105-120). There is no local sales tax on these services.

House Bill 1126 was introduced in April 1997 when pay telephone calls were regulated so that the owners were not permitted to raise the price of a call above 25¢. The owners complained that the sales tax forced them to operate at a loss because they could not increase the price of the calls to cover the tax. Later in 1997, however, pay telephones were deregulated and the price of most calls immediately increased by 40% or more, generating more than enough revenue to cover the 3% tax. Therefore, the effect of this act is to grant additional tax relief to pay phone owners.

Current law is very inconsistent with regard to sales taxes on sales from coin-operated machines. The following table shows the current law treatment:

Type of Coin Sale	State Sales Tax	Local Sales Tax	Tax Break
Phone Calls	0%	None	Exempt
Cigarettes	4%	2%	None
Soft Drinks	4%	2%	None
Other Vending Sales	4%	2%	50% Reduction

Washers & Dryers	0%	0%	Exempt

Coin-operated washers and dryers are exempt from sales tax. Sales taxes on other coin-operated vending machines, except soft drink and cigarette machines, are reduced by 50%. Sales taxes on coin-operated soft drink and cigarette machines are subject to the full 4% State sales tax and 2% local sales tax. Vending machine sales of food and beverages do not qualify for the reduced State sales tax on food, and are not subject to local prepared meals taxes.

S.L. 1998-218 (Senate Bill 1554, Senator Rand)

AN ACT TO AMEND THE EXCISE TAX ON CONTROLLED SUBSTANCES.

This act reduces certain tax rates of the excise tax on controlled substances in order to remove features of the tax found unconstitutional by the United States Court of Appeals for the Fourth Circuit in Lynn v. West.[10] It also removes the 50% penalty for failure to pay the tax and provides instead that interest and penalties for this tax will be the same as for all other taxes. The tax, at these new, lower rates, is expected to generate $1.3 million in General Fund revenues and $3.9 million for State and local law enforcement agencies. The act became effective October 26, 1998.

The purpose of the tax rate reductions is to remove features of the tax that caused the federal court to hold it unconstitutional. If these rate reductions have the effect of rendering the tax constitutional, then the State can collect the tax. If a court later holds that these rate reductions did not render the tax constitutional, the State could be required to refund taxes illegally collected or to rescind criminal drug prosecutions. The rate reductions appear to address the federal court's concerns but, because the federal court did not provide a clear test of what would make the tax constitutional, there remains some risk that the tax might later be invalidated again notwithstanding the rate reductions. The issues, outlined below, are complex.

In Lynn v. West, the federal court ruled that the controlled substance tax was, "in reality," a criminal penalty rather than a tax, and could not be enforced without all the criminal procedure safeguards guaranteed by the Fifth and Sixth Amendments of the United States Constitution. As a result of the Lynn case, the Department of Revenue was forced to stop collecting the tax on the date the opinion was issued, January 13, 1998. The Department of Revenue did not stop collecting the tax on illicit spirituous liquor, however. The United States Supreme Court declined to review the Lynn case, so the case is now the controlling law.

The double jeopardy clause was not an issue in the Lynn case because only the federal government, not the State, had brought criminal charges against Lynn for illegal drug possession. The double jeopardy clause protects against successive prosecutions by the same sovereign, but not against prosecutions by different sovereigns. The holding in the Lynn case that the tax is a criminal penalty means, however, that North Carolina would not be able to collect the tax from an individual and also prosecute the individual for a criminal drug violation. Therefore, the State was required to drop criminal charges against some drug defendants who had also been assessed the controlled substance tax.

[10] Lynn v. West, 134 F.3d. 582, cert. denied, 119 S. Ct. 47 (1998).

The federal court in the Lynn case analyzed the tax under the United States Supreme Court's 1994 Kurth Ranch[11] case holding Montana's illegal drug tax unconstitutional because it was a second punishment, not a true tax, and thus violated the double jeopardy clause of the Fifth Amendment. In analyzing a civil measure to determine if it is in fact a criminal penalty, the court will look first at whether the legislature intended it as a civil penalty and second, even if it is so intended, whether it is so punitive either in purpose or in effect to transform it into a criminal penalty. The Court in the Kurth Ranch case stated that the tax must be examined as a whole to determine whether it has crossed the line to becoming a criminal punishment. Neither a high rate of tax alone nor an obvious deterrent purpose alone would make a tax a criminal punishment, but these factors are significant, the Court ruled. The Court found both these factors present in the Montana law, as well as the fact that the tax was conditioned on the commission of a crime and had no relationship to lawful possession.

In the Lynn case, the federal court found that all four of these same factors were present in North Carolina's controlled substance tax: a high rate of tax, a deterrent purpose, application only to illegal activity, and no relationship to lawful possession. For this reason, the court ruled that North Carolina's controlled substance tax is a criminal penalty. This act lowers the tax rates, and the civil penalty for failure to pay, in the hope of addressing the first factor, high rates. It would be difficult to address the deterrent purpose of the tax, its application only to illegal drug possession, or its lack of a relationship to legal position.

Nearly a kilogram of cocaine was seized from Lynn in 1993. The tax rate was $200 a gram, with a penalty equal to 100% of the tax.[12] Although no evidence of the value of cocaine had been offered, the court found that its market value was $25,000 a kilogram, which translates to $25 a gram. Thus, the court found the tax rate to be eight times the market value of the cocaine, which, when combined with the 100% tax penalty, yielded a total tax that was sixteen times the market value of the cocaine. The tax rate in the Kurth Ranch case, by comparison, was eight times the market value of the drug. The Lynn court's concern with North Carolina's high tax rate was compounded by the fact that the full rate applies no matter how pure or dilute the controlled substance may be.

This act provides a separate tax rate of $50 a gram for cocaine and changes the tax rate on drugs sold by dosage units from $400 to $200 per ten dosage units. Crack cocaine is sold in dosage units. The bill also reduces the 50% failure to pay penalty to 10%, to keep it in line with a 1998 reduction in the tobacco tax penalty. Based on the court's holding that cocaine's market value is $25 a gram, the proposed rate tax would be twice the market value; when the 10% penalty is added, the total would be only slightly more than twice the market value. The act does not address the court's concern that the same tax rate applies whether the substance is pure or dilute.

The General Assembly enacted the excise tax on controlled substances in 1989 as a means of generating revenue for State and local law enforcement agencies and for the General Fund. Under the law, a person who acquires illegal drugs is required to pay tax on them within 48 hours of acquiring possession if the tax has not already been paid as evidenced by a tax stamp. A person paying the tax is not required to disclose his or her identity and any information obtained in assessing the tax is confidential and cannot be used in a criminal prosecution other than a prosecution for failure to comply with the tax statute itself. Seventy-five percent of the

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[11] Department of Revenue v. Kurth Ranch, 511 U.S. 767 (1994).

[12] The tax on marijuana is $3.50 a gram, except for separated stems and stalks, which are taxed at 40 cents a gram. The tax on "low-street-value" drugs is $50.00 for ten dosage units and the tax on other drugs not sold by weight is $400.00 for ten dosage units.

revenue generated by assessments of the tax is distributed to the law enforcement agencies whose investigation led to the assessment. The remainder of the revenue is credited to the General Fund.

The North Carolina Court of Appeals upheld the constitutionality of the State's excise tax on controlled substances in 1996 and the North Carolina Supreme court affirmed March 7, 1997. Because the constitutionality of the tax depends on an interpretation of the federal constitution, the federal courts are not bound by the opinion of the North Carolina courts.

S.L. 1998-212 (Senate Bill 1366, Senator Plyler)

AN ACT TO MODIFY THE CURRENT OPERATIONS AND CAPITAL IMPROVEMENTS APPROPRIATIONS ACT OF 1997 AND TO MAKE OTHER CHANGES IN THE BUDGET OPERATION OF THE STATE.

The Current Operations Appropriations and Capital Improvement Appropriations Act of 1998 contains the following thirteen tax law changes:

1. Repeals the State sales tax on food.
2. Repeals the State inheritance tax.
3. Allows public schools to obtain an annual sales tax refund.
4. Extends the deduction for subsidiary dividends to foreign corporations.
5. Allows a State individual income tax credit for long-term care insurance.
6. Decreases the insurance regulatory charge from 8.75% to 6%.
7. Sets the public utility regulatory fee at 0.09%.
8. Increases the conservation tax credit for corporate and individual taxpayers.
9. Amends the Revenue Act to make tax penalties uniform.
10. Extends the sunset for the qualified business investment tax credit.
11. Modifies the qualified business investment tax credit for the movie industry.
12. Directs a study of taxpayer attorney fees.
13. Revises the property tax exemption for continuing care retirement homes.

Repeal State Sales Tax on Food.

In 1996, the General Assembly reduced the State sales tax on food from 4% to 3%, effective January 1, 1997. In 1997, the General Assembly reduced the State sales tax on food from 3% to 2%, effective July 1, 1998. This act completes the reduction by eliminating the remaining 2% State sales tax on food, effective May 1, 1999. The act also authorizes the Secretary of Revenue to earmark up to $174,000 of sales tax collections for 1998-99 for the administrative costs of revising and mailing forms. This section of the act is expected to reduce General Fund revenues by $18.4 million in fiscal year 1998-99, $184.5 million in fiscal year 1999-2000, $190 million in fiscal year 2000-01, $195.7 million in fiscal year 2001-02, and $201.6 million in fiscal year 2002-03.

The sale of tangible personal property in North Carolina is subject to a 4% State sales tax unless it is specifically exempt from the tax. In 1971, 1983, and 1986, the General Assembly passed legislation allowing local governments to impose a local sales tax. The local

sales tax rate is 2%. On most tangible personal property, the combined State and local sales tax rate is 6%. However, because of past legislation reductions, the combined State and local sales tax rate on food, effective July 1, 1998, was 4%. This section of the act repeals the State's remaining 2% sales tax rate on food, but retains the 2% local sales tax rate. Therefore, when the provision becomes effective, there will only be a local 2% sales tax on food.

The sales tax on food applies to food that may be purchased with food stamps or other methods under the food stamp program. Federal law determines what can be purchased under the food stamp program and, therefore, what food is exempt from the State sales tax. Food purchased with food stamps is already exempt from both the State and the local sales tax, as required by federal law.

Eliminate North Carolina Inheritance Tax.

The act repeals the State's inheritance tax but retains a State estate tax that is equivalent to the federal state death tax credit allowed on a federal estate tax return. This type of State estate tax is known as a "pick-up" tax because it picks up for the State the amount of federal estate tax that would otherwise be paid to the federal government. The repeal of the State's inheritance tax is effective January 1, 1999, and applies to the estates of decedents dying on or after that date. This section of the act is expected to reduce General Fund revenues by $52.5 million in fiscal year 1999-2000, $79.4 million in fiscal year 2000-01, $85.7 million in fiscal year 2001-02, and $92.6 million in fiscal year 2002-03.

Under prior law, North Carolina imposed an inheritance tax on property transferred by a decedent. The amount of tax payable depended on the relationship of the person transferring the property (the decedent) to the person receiving the property (the beneficiary). This was in contrast to federal law, which has a single rate schedule for estates.

State law classified beneficiaries into three classes and set different inheritance tax rates for each class. A Class A beneficiary was a lineal ancestor, a lineal descendant, an adopted child, a stepchild, or a son-in-law or daughter-in-law whose spouse was not entitled to any of the decedent's property. A Class B beneficiary was a sibling, a descendant of a sibling, or an aunt or uncle by blood. A Class C beneficiary was anyone who was not a Class A or Class B beneficiary.

Class A beneficiaries had the lowest inheritance rates and a $600,000 inheritance tax exemption. Class B beneficiaries had higher rates and no exemption. Class C beneficiaries had the highest rates and no exemption. Thus, North Carolina's rate structure favored transfers to children and parents by giving those transfers the lowest rates plus an exemption and preferred transfers to other close family members over transfers to more distant relatives or to persons who were not related.

Sales Tax Refunds for Schools.

This section of the act adds local school administrative units to the list of governmental entities that may obtain an annual refund of the State and local sales and use taxes paid by them. The change became effective July 1, 1998, and applies to taxes paid on or after that date. The refunds apply to direct purchases of tangible personal property. They also apply to sales and use tax liability indirectly incurred by a local school administrative unit on building materials, supplies, fixtures, and equipment that become a part of any building that is owned or leased by the unit and is being built, altered, or repaired for use by the unit. To obtain the refund, a local school administrative unit must request the refund in writing within six months after the end of the unit's fiscal year. The request must include any information and

documentation required by the Secretary of Revenue. This section of the act is expected to reduce General Fund revenues by $14.8 million in fiscal year 1999-2000, $15 million in fiscal year 2000-01, $14.4 million in fiscal year 2001-02, and $12.6 million in fiscal year 2002-03.

Prior to 1961, the State granted sales and use tax exemptions to State and local governmental entities, including public schools, and nonprofit entities. Because of the number of abuses involving the exemption and the difficulty of auditing these transactions, the General Assembly changed the law in 1961 to allow refunds as opposed to outright exemptions. The statute lists those entities that are entitled to a refund. Nonprofit educational institutions, as well as most other nonprofit entities, are entitled to a semiannual refund of State and local sales and use tax.

The General Assembly did not include State agencies in the list of entities entitled to an annual refund of State and local sales taxes because the refund process would not benefit the General Fund, from which the agencies receive their appropriations, and would create unnecessary paperwork for the agencies. The General Assembly did not include public schools in the list of entities entitled to an annual refund for similar reasons. First, public school books and school lunches are exempt from sales tax. Second, most of the operating money for public schools comes from the General Fund, although most of the capital money comes from the counties.

Prior to the act, although a school board could not receive sales tax refunds, a county was entitled to a refund of State sales and use taxes paid if it purchased items on behalf of its school board. More than one-half of the counties have statutory authority to acquire property on behalf of their school boards and thus may receive sales tax refunds if they exercise that authority. The other counties do not have this authority, although the Attorney General's Office has stated that they may acquire property on behalf of their school board if they enter into an interlocal agreement with the school board. Under this act, the school board can receive the refunds directly, without having to arrange for the county to acquire the property and apply for the refunds on its behalf.

Corporate Dividend Technical Change.

This section of the act extends the deduction for subsidiary dividends to corporations domiciled in other States. This is a technical change only because, due to the requirements of the Interstate Commerce Clause of the United States Constitution, the Department of Revenue was forced in 1997 to extend the deduction to out-of-state corporations. The statutory change conforms the statutes to the current practice and to the requirements of the Constitution. This provision passed both the House and the Senate in 1997 but was not enacted that year.

Under prior law, G.S. 105-130.7 allowed a corporation domiciled in North Carolina that held more than 50% of the outstanding voting stock of another corporation (a subsidiary) to deduct dividends it receives from the subsidiary plus any expenses related to the dividends. The restriction of this deduction to North Carolina corporations created interstate commerce clause problems in light of the United States Supreme Court's 1996 Fulton decision, which struck down a similar provision in the intangibles tax. The Attorney General's Office advised the Department of Revenue that, if the General Assembly did not resolve the constitutional problem with this tax preference, the Department of Revenue could not enforce it. There was too much risk of personal liability on the part of Department of Revenue personnel in enforcing a provision that was so clearly flawed in the wake of the Fulton decision. This section of the act resolves the constitutional problem by extending the deduction to non-North Carolina companies, as the Department of Revenue had already done administratively.

The 1994-95 Revenue Laws Study Committee had recommended a different solution to this problem: allowing both North Carolina corporations and non-North Carolina corporations to deduct subsidiary dividends but not expenses related to the deductible dividends. The Revenue Laws recommendation was based on the basic tax principle that expenses related to untaxed income should not be deductible from taxed income. This policy is reflected in section 265 of the Internal Revenue Code and in G.S. 105-130.5(c)(3). The Revenue Laws Study Committee's recommendation was introduced in 1996, but was not enacted.

Credit for Long-Term Care Insurance.

This section of the act allows a State individual income tax credit of 15% of the premium paid each year on long-term care insurance. The credit may not exceed $350 for each policy for which the credit is claimed. The credit may not exceed the amount of tax owed by the taxpayer, and there is no provision to allow unused portions of the credit to be carried forward. The credit becomes effective for taxable years beginning on or after January 1, 1999, and expires for taxable years beginning on or after January 1, 2004. This section of the act is expected to reduce General Fund revenues by $7.98 million in fiscal year 1999-2000, $8.87 million in fiscal year 2000-01, $9.82 million in fiscal year 2001-02, and $10.89 million in fiscal year 2002-03. The Legislative Research Commission is directed to study the effect of the credit on the State's Medicaid costs and to report its finding to the 2004 Session of the 2003 General Assembly.

A taxpayer may claim a credit for policies that provide coverage for either the taxpayer, the taxpayer's spouse, or a family member for whom the taxpayer provides over half of the support and whose income is below an exemption amount. A long term-care insurance policy is one that provides only coverage of long-term care services and that meets the following requirements:

1. Is guaranteed renewable.
2. Does not provide for a cash surrender value.
3. Provides that refunds and dividends may be used only to reduce future premiums or to increase future benefit.
4. Does not pay or reimburse expenses that are reimbursable under Medicare.
5. Satisfies consumer protection laws.

Under federal law, premiums paid on long-term care insurance contracts are treated as deductible medical expenses. Under the medical expense itemized deduction, unreimbursed medical expenses may be deducted to the extent that the expenses exceed 7.5% of adjusted gross income. To the extent a taxpayer will receive a deduction for long-tern care insurance premiums under the Code, the taxpayer will receive a deduction for State income tax purposes as well since North Carolina uses federal taxable income as the starting point for calculating State taxable income. To prevent a double tax benefit in those cases, the credit is limited to those expenses for which a deduction has not been claimed. The language in the act concerning no double tax benefit is identical to the language used in the credit for child health insurance enacted earlier in 1998.

Insurance Regulatory Charge.

The act decreases the insurance regulatory charge from 8.75% to 6%, effective January 1, 1998. This charge was first imposed in 1991. Its purpose is to make the Department of Insurance receipt-supported and thereby eliminate General Fund support of the Department.

The regulatory charge is imposed on insurance companies that pay the gross premiums tax, other than service corporations such as Blue Cross/Blue Shield and Delta Dental Corporation. Health maintenance organizations do not pay the regulatory charge because they do not pay the gross premiums tax. The charge is a percentage of the insurance company's premiums tax liability.

In 1997, the General Assembly clarified that the premiums tax liability upon which the charge is levied is not reduced by any tax credits allowed a taxpayer for guaranty or solvency fund assessments. This change explains in part the reason why the charge is able to be decreased this fiscal year by 2.75%. The act ensures that the regulatory charge will continue to be based upon gross premium tax collections by providing that the premium tax liability upon which the charge is levied is not reduced by any tax credits allowed a taxpayer under Chapter 105 of the General Statutes. The Economic Opportunity Act of 1989, passed this session by the General Assembly, allows a tax credit against the gross premiums tax for investing in central administrative office property.

Public Utility Regulatory Fee.

The act sets the public utility regulatory fee for fiscal year 1998-99 at 0.09%. This rate maintains the current 0.09% rate set in fiscal year 1997-98. The utility regulatory fee was imposed in 1989. Its purpose is to defray the State's cost in regulating public utilities. The regulatory fee is imposed on all utilities that are subject to regulation by the North Carolina Utilities Commission. The fee is a percentage of the utility's North Carolina jurisdictional revenues. In general, jurisdictional revenue is revenue derived from providing utility service in North Carolina.

Amend Conservation Tax Credits.

For taxable years beginning on or after January 1, 1999, the act increases an individual taxpayer's limit for the conservation tax credit from $100,000 to $250,000 and increases a corporate taxpayer's credit limit from $250,000 to $500,000. This section of the act is expected to reduce General Fund revenues each fiscal year by $1.2 million. In 1997, the General Assembly increased the individual credit limit from $25,000 to $100,000, and increased the corporate credit limit from $25,000 to $250,000. The act also repeals the requirement that individual taxpayers add back the fair market value of the donated real property to their taxable income. This add-back requirement was originally placed in the law to prohibit individual taxpayers from receiving both a tax credit and a charitable deduction for the donated property.

This tax credit is allowed to individual and corporate taxpayers who make a qualified donation of an interest in North Carolina real property that is useful for public beach access or use, public access to public waters or trails, fish and wildlife conservation, or other similar land conservation purposes. The tax credit is equal to 25% of the fair market value of the property donated to 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. Both corporate and individual taxpayers are allowed to carry forward for five years any unused portion of the credit.

North Carolina is the only state that allows a conservation tax credit. The credit was enacted in 1983. The General Assembly did not want an individual to receive a double tax benefit for the donation, so it prohibited a charitable contribution deduction for the portion of the donation used to calculate the tax credit. In 1989, federal taxable income became the starting point in determining North Carolina taxable income. In order to maintain the single tax

benefit, an addition to the federal taxable income in the year of the donation was required in the amount of the fair market value of the donated property. This add-back can be a disincentive to donating property in two cases:

1. If the taxpayer never deducts the entire fair market value of the donation as a charitable deduction. This situation can occur because the federal law imposes limitations on the amount of charitable contributions deductions in any year based on the taxpayer's adjusted gross income (usually 30% of adjusted gross income).
2. If the taxpayer never claims the entire tax credit for the donation. This can occur because the taxpayer may be unable to claim the entire amount of the credit within the six-year period.

The act remedies these disincentives by no longer requiring an individual taxpayer to add the fair market value of the donated property to federal taxable income in arriving at North Carolina taxable income. This change results in an individual taxpayer receiving both a charitable contribution deduction and a tax credit for the donation. Current law does not allow a corporation to take a charitable contribution deduction for its donation.

Under the Internal Revenue Code, a donation of real property for conservation purposes is treated as a charitable deduction. A qualified appraisal of the donated land is required if the claimed deduction is more than $5,000. This appraisal must be attached to the federal tax return. No appraisal is required by the North Carolina Department of Revenue.

Revenue Penalties Uniform.

The act amends several sections of the Revenue Act to make tax penalties uniform. This portion of the act was requested by the Department of Revenue and recommended by the Revenue Laws Study Committee. These amendments, which are effective January 1, 1999, do the following:

- Repeal several penalties that are obsolete or ineffective.
- Provide that refunds of sales taxes, motor fuel taxes, and excise taxes on sacramental wine are barred only if filed more than 3 years after their due date. The current law provides a reduction of the amount refunded for late applications filed before the 3-year period expires.
- Clarify that additional taxes are assessable as penalties so that it is clear the taxes may be waived by the Secretary. The act also clarifies that penalties are assessable as additional taxes to ensure the taxpayer receives the full administrative and judicial remedies applicable to tax assessments. This clarification conforms with the following statutory definition of "tax" in G.S. 105-228.90: "[T]he terms 'tax' and 'additional tax' include penalties and interest as well as the principal amount."
- Provide a uniform penalty for most tax deficiencies that exceed 25% of the tax liability.
- Expand the statute concerning the personal liability of corporate officers who fail to remit certain taxes when due to include the manager and managing members of a limited liability company.

Extend Qualified Business Credit Sunset.

The act extends the sunset for the qualified business investment tax credit an additional four years, until the year 2003. The act retains the current $6 million cap on the credit. This change became effective when the act became law on October 30, 1998.

The qualified business investment tax credit was enacted in August 1987 to promote economic development for North Carolina businesses. The initial credits applied to both corporations and individuals taxpayers, and there was a $12 million cap on the total amount of all tax credits. In response to a 1996 United States Supreme Court decision in Fulton Corp. v. Faulkner, the General Assembly reduced the $12 million cap to $6 million, limited the credit to individuals and small pass-through entities, and removed the requirement that the qualified businesses be headquartered or operating in North Carolina. The credit was to expire for investments made on or after January 1, 1999. The act extends the credit for four additional years until January 1, 2003.

The credit is allowed for an individual taxpayer who purchases the equity securities or subordinated debt of a qualified business venture or a qualified grantee business directly from that business. The credit is equal to 25% of the amount invested and may not exceed $50,000 per individual in a single taxable year. An individual investor may also claim the allocable share of credits obtained by "pass-through entities" of which the investor is an owner. Pass-through entities include limited partnerships, general partnerships, S corporations, and limited liability companies. The credit may not be taken in the year the investment is made. Instead, the credit is taken in the year following the calendar year in which the investment was made, but only if the taxpayer filed an application with the Secretary of State. The unused credit may be carried forward for the next five years. The total amount of credits allowed to all taxpayers for investments made in a calendar year may not exceed $6 million. The Secretary of Revenue calculates the total amount of tax credits claimed from applications filed with the Secretary of State. If the amount exceeds the cap, then the Secretary allows a portion of the tax credits claimed by allocating the total of $6 million in tax credits in proportion to the size of the credit claimed by each taxpayer.

Under the 1996 Fulton case, the original credit provisions clearly violated the interstate commerce clause of the federal constitution because they reduced a taxpayer's tax liability by an amount equal to 25% of the cost of purchasing stock in either a North Carolina business or an investment company whose purpose is to invest in North Carolina businesses, while no tax reduction was allowed for purchasing similar stock in out-of-state businesses or investment companies whose purpose is to invest in businesses that may not be North Carolina businesses. In response to the Fulton case, the Revenue Laws Study Committee discussed this credit along with several others, at great length. The original proposal of the Committee was to repeal all qualified business investment credits, effective January 1, 1997. In response to appeals to the Committee and to the General Assembly, the credit was expanded to include investments in businesses located both inside and outside North Carolina, but was no longer allowed for investments in investment companies and was limited to investments made by individuals and small pass-through entities under the theory that these investors are not likely to invest outside of a 50-mile radius of their home.

Qualified Business Credit for Movies.

The act modifies the qualified business investment tax credit to make it more accessible for investors who provide capital for the film industry, effective for taxable years beginning on

or after January 1, 1999. Specifically, the act modifies the qualified business investment tax credit in two ways:

1. Allows a qualified business venture in the film industry to pay off its investors in less than five years without causing the investors to forfeit the tax credit.
2. Provides that the effective date of registration for a qualified business venture whose application is accepted for registration is 60 days before the date its application was filed.

To be a qualified business venture eligible for the qualified business investment tax credit, the business must be engaged primarily in manufacturing, processing, warehousing, wholesaling, research and development, or a service-related industry and the business must be registered with the Secretary of State. The film industry is eligible to qualify for the credit, as a service-related industry.

To obtain a tax credit, a person must purchase the equity securities or subordinated debt directly from the qualified business. Subordinated debt is indebtedness that by its terms matures five or more years after its issuance, is not secured, and is subordinated to all other indebtedness. A taxpayer forfeits the credit if the qualified business redeems the securities purchased by the taxpayer within five years after the investment was made. In the film industry, a project in which a person may invest does not usually last five years, making it difficult to satisfy the five-year minimum for the investment. The act addresses this problem by allowing a business engaged primarily in the film production industry to redeem its securities within five years and to mature its subordinated debt within five years without causing an investor to forfeit the tax credit. The act provides that this redemption is allowed only if (1) the redemption occurred because the qualified business venture completed the production of a film, sold the film, and was liquidated, and (2) neither the qualified business venture nor a related person continues to engage in business with respect to the film produced by the venture.

Under former law, no tax credit was allowed for an investment made in a qualified business venture before the date of the business's registration with the Secretary of State. In the film industry, a person invests in a project before the project is started. The practice is that the investments are placed in an escrow account until a sufficient amount of capital is obtained to begin a film's production. If enough funds are not raised, then the money in escrow is returned to the investors. To accommodate this unique situation, the act extends the time in which a taxpayer may make an eligible investment. It provides that the effective date of a business's registration is 60 days before the date its application is filed, as opposed to the date it is filed. The act also provides that if a taxpayer's investment is placed initially in escrow conditioned upon other investors' commitment of additional funds, the date of the taxpayer's investment is the date escrowed funds are transferred to the qualified business venture free of the condition, as opposed to the date the investment was actually made.

Study Taxpayer Attorney Fee Issue.

The act directs the Revenue Laws Study Committee to study whether the State should reimburse a taxpayer for legal costs when the taxpayer substantially prevails in an administrative appeal or lawsuit with respect to the amount in controversy or with respect to the most significant issue or set of issues presented. Rule 11 of the North Carolina Rules of Civil Procedure is the general rule governing when a party to a legal action may recover reimbursement for legal costs, including attorney fees. Under this Rule, a party may be ordered to reimburse the other party its legal costs, including a reasonable attorney's fee, when the party's case is not well grounded in fact and law or is begun for an improper purpose, such as

to harass the other party. This Rule is used in court actions, but does not apply to administrative appeals before the Tax Review Board. The Revenue Laws Study Committee is directed to report its recommendations to the 1999 General Assembly.

Continuing Care Retirement Homes Exempt.

The act temporarily revises an existing property tax exemption for retirement facilities that was recently held unconstitutional by the North Carolina Supreme Court.[13] The act exempts nonprofit continuing care retirement communities (CCRCs) whose governing body is not self-perpetuating but is selected by another publicly supported 501(c)(3) nonprofit. The act was agreed to by the Association of County Commissioners, the Association for Nonprofit Homes for the Aging, and other interest groups representing nonprofit entities of various types. It effectively restores the exemption for those CCRCs that were exempt under the law struck down by the court, but retains taxability of those CCRCs that have been taxed all along. It does not affect charitable homes for the aging, which are exempt under current law and were not affected by the court case.

The exemption will remain in effect for two years, the 1998-99 and 1999-2000 property tax years. During this period, the act directs the Legislative Research Commission to study the issue of property tax exemptions for nonprofit institutions in general and to report its findings and recommendations to the 2000 Regular Session of the 1999 General Assembly.

The distinction between CCRCs that have a governing body selected by a publicly supported 501(c)(3) and CCRCs that have a self-perpetuating governing body is rational under the constitution. A self-perpetuating nonprofit is less answerable to the public. The Internal Revenue Code recognizes the important distinction between publicly supported 501(c)(3)s and other 501(c)(3)s (private foundations). A publicly supported 501(c)(3) that selects the CCRC's governing body is more answerable to the public and less controlled by private interests.

Property owned by a nonprofit home for the aged, sick, or infirm is exempt from property tax if used for a charitable purpose.[14] A charitable purpose is defined as "one that has humane and philanthropic objectives; it is an activity that benefits humanity or a significant rather than limited segment of the community without expectation of pecuniary profit or reward." The property tax exemption set out in the act is necessary because some continuing care retirement centers may not be charitable and therefore would not qualify for this exemption. In the 1980s, two cases held that certain continuing care retirement centers were not charitable for purposes of property tax exemption.[15] In concluding that the institutions were not charitable in these cases, the court noted the following facts about one or both institutions:

1. The institution refused to admit applicants with health problems rendering them physically unable to care for themselves.
2. Substantial entrance fees and monthly fees were required from all residents, and applicants had to demonstrate that they were financially capable of supporting themselves for the period of their life expectancy.

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[13] In re Springmoor, 348 N.C. 1 (1998).

[14] G.S. 105-278.6. In addition, retirement centers that are funded by North Carolina Medical Commission bonds are also exempt from property taxes under G.S. 131A-21 as long as the bonds are outstanding. See In re Appeal of Glenaire, (N.C. Ct. App. 2/7/95, unpublished), rev. denied 360 N.C. 261 (1995).

[15] In re Chapel Hill Residential Retirement Center, 60 N.C. App. 294, rev. denied, 308 N.C. 386 (1983); In re Appeal of Barham, 70 N.C. App., rev. denied, 312 N.C. 622 (1984).

3. The operation of the institution was funded entirely or mainly from fees paid by residents, not by donations or endowments.
4. The costs were so high that only a small percentage of the elderly could afford the home.[16]
5. The home retained the right to terminate a resident for nonpayment of fees unless nonpayment was beyond the resident's control.

In each case, the court concluded that merely supplying care and attention to elderly pensions cannot, alone, constitute charity. The court found that these retirement communities were not providing for the special needs of individuals who are in need of charity, the aid of whom benefits society as a whole in addition to the residents. The court in one case also noted that allowing such a retirement home to qualify because its residents were elderly would give those residents preferential treatment over the elderly who live in their own homes and must pay property taxes.[17]

Under the act, an institution that fails to qualify as charitable will receive a property tax exemption for its property if it meets all of the following conditions:

1. The institution owns the property and uses it for a retirement community that includes a skilled nursing facility or an adult care facility and also includes independent living units. (In other words, as under prior law, the exemption applies to continuing care retirement communities, but not stand-alone nursing homes or rest homes.)
2. The institution must be nonprofit and exempt from income tax, and its assets upon dissolution must revert to a 501(c)(3) charitable organization.
3. The institution must have an active fund-raising program to assist it in providing services to those who do not have the financial resources to pay the fees.
4. The governing body of the institution must be selected by a charitable nonprofit that is exempt under section 501(c)(3) of the Internal Revenue Code and is a publicly supported charity. (A publicly supported charity is a charity that is not a private foundation under section 509 of the Code).

From its enactment in 1987 until it was struck down by the North Carolina Supreme court as unconstitutional in 1998, G.S. 105-275(32) provided a property tax exemption for continuing care retirement centers that were owned and operated by religious or Masonic organizations. The court found that the exemption was an establishment of religion in violation of the First Amendment of the United States Constitution. The effect of the court case is that the property of continuing care retirement centers previously exempt under the statute would have been taxable beginning with the 1998-99 property tax year, unless they qualified for exemption as charitable homes under G.S. 105-278.6.[18] There would be no taxation for earlier

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[16] According to another case, Southminster, Inc. v. Justus, 119 N.C. App. 669 (1995), the average annual income in 1988 of residents of the Pines was $43,000 and their average net worth was $444,000. At Southminster, 88% of residents had net worths over $200,000 and 63% had net worths over $350,000.

[17] Low-income elderly homeowners qualify for partial exemption under the homestead exemption. G.S. 105-277.1.

[18] The Springmoor case does not affect the sales tax refunds to which continuing care retirement centers are entitled under G.S. 105-164.14. Under the Southminster case, cited above, these homes are considered charitable for purposes of sales tax refunds even if they do not qualify as charitable for property tax purposes.

years, however. As earlier noted, this act temporarily revises this property tax exemption effective for taxes imposed for taxable years beginning on or after July 1, 1998.

1997

Prepared by Cindy Avrette, Martha H. Harris, and Martha K. Walston

S.L. 1997-6 (Senate Bill 33, Senator Cochrane)

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

This act makes numerous technical and clarifying changes to the revenue laws and related statutes. These changes were recommended to the 1997 General Assembly by the Revenue Laws Study Committee. The following table provides a section-by-section analysis of the proposed changes.

Sec.	Explanation
1	Repeals an obsolete statute that requires gun owners to list their guns for property taxes. This statute is not needed because nonbusiness personal property is exempt from property taxes and the listing requirements for business personal property are contained in the Machinery Act.
2	Increases the inheritance tax return filing threshold for Class A beneficiaries from $450,000 to $60[1]0,000 to conform to the increased credit enacted in 1996. This change became effective January 1, 1997, and applies to estates of decedents dying on or after that date.
3 - 4	Correct incorrect cross-references to the North Carolina Building Code and Building Accessibility Section of the Department of Insurance and modernize language.
5	Places definitions in alphabetical order and renumbers them. The definition of "security" was out of order and could not be included in the correct order with-out renumbering the list of definitions.
6	Deletes the definition of "fiduciary" from the with-holding tax Article because the term is not used in the Article.
7	Removes improper quotation marks.
8	Restores language that was inadvertently deleted in 1996 due to a redlining error.
9	Corrects a grammatical error.
10	Restores the missing word "the".
11	Restores the missing word "or".
12 - 15	Make it clear that the per gallon motor fuel tax refunds do not apply to the inspection tax.

[1]

16 Repeals three obsolete subsections concerning taxes payable by electric membership corporations for 1965 and 1966.

17 - 18 Make it clear that a motor fuel supplier that sells kerosene is not required to have a separate license as a kerosene supplier.

19 Makes a conforming change to a cross-reference to a subdivision and modernizes language.

20 Deletes an improper comma and modernizes language.

21 Provides a savings clause.

22 Provides that the act became effective when it became law, March 21, 1997.

S.L. 1997-17 (Senate Bill 388, Senator Hoyle)

AN ACT TO PROHIBIT THE ASSESSMENT OF INTANGIBLES TAX FROM TAXPAYERS WHO BENEFITED FROM THE TAXABLE PERCENTAGE DEDUCTION IN THE FORMER INTANGIBLES TAX STATUTE.

On February 10, 1997, the North Carolina Supreme Court held that the taxable percentage deduction in the North Carolina intangible tax on stock violated the commerce clause by discriminating against out-of-state companies. The deduction reduced a taxpayer's liability for the tax in proportion to the amount of business the corporation did in North Carolina. The court did not order refunds. Instead, it allowed the possibility of curing the past discrimination by the assessment of intangibles tax on those who did not pay in reliance on the unconstitutional taxable percentage deduction. Upon the advice of the Attorney General's Office, the Secretary of Revenue began preparing to assess the intangibles tax on those who did not pay the tax in reliance on the unconstitutional taxable percentage deduction.

In response to the Secretary's preparations, the General Assembly ratified this act. This act directs the Secretary of Revenue to take no action to collect or assess back intangibles tax for tax years 1990 through 1994. In effect, this act foreclosed the possibility of assessments on those who relied on the taxable percentage deduction. The passage of this act made the State liable for refunds to those intangibles taxpayers who paid tax on shares of stock and who protested the payment of the tax within 30 days of payment. The General Assembly enacted House Bill 96, S.L. 1997-318, on July 21, 1997. S.L. 1997-318 directs the Secretary of Revenue to make refunds of the intangibles tax to taxpayers who filed a timely protest.

The General Assembly repealed the intangibles tax in 1995. The potential for the Department of Revenue to assess and collect the intangibles tax on those taxpayers who did not pay intangibles tax prior to 1995 in reliance on the unconstitutional taxable percentage deduction resulted from the North Carolina Supreme Court's 1997 decision in the Fulton case. In 1995, the Department estimated that eliminating the taxable deduction in the North Carolina intangibles tax on stock would generate $55 to $75 million dollars. As a practical matter, however, it would be difficult for the Department to discover and value taxable shares in those North Carolina corporations that are not publicly traded because there is no public information on these holdings.

S.L. 1997-23 (House Bill 295, Representative Cansler)

AN ACT TO EXEMPT MOST INTANGIBLE PERSONAL PROPERTY FROM PROPERTY TAX.

This act exempts from local property taxes all intangible property except leasehold interests in exempted real property. The act became effective July 1, 1997, and applies to taxable years beginning on or after that date. The act is not expected to result in a significant decrease in local government property tax revenues.

Intangible personal property has been subject to property taxes for over 100 years. The property is taxable unless specifically excluded. Although cash and bank deposits have been excluded from property tax since 1985, it was not until 1995 that the General Assembly excluded other forms of financial intangibles, such as stocks, bonds, accounts receivable, and beneficial interest in trusts, from property tax. These financial intangibles were taxed by the State and the revenues generated by the tax were distributed to local government units. The intangibles tax repeal in 1995 repealed the tax on intangible property that was levied by the State; it did not affect the local governments' power to tax intangible property that had not been taxed by the State and was not otherwise excluded from local property taxation.

This act exempts most of the remaining forms of intangible personal property, such as franchise rights, patents, copyrights, trademarks, and goodwill, from property taxation. The tax situs of a business intangible is generally the location of the company's headquarters. Most counties have never taxed this type of property even though it was clearly subject to tax. Two recent developments raised county tax assessors' awareness of this potential revenue source. First, the Uniform State Abstract for listing business personal property, prepared by the Department of Revenue, was revised for use beginning in tax year 1997 to include a specific schedule D for intangible property. The memorandum accompanying the new abstract advised that the appraisal of intangible property would be a first time endeavor for many appraisers across the State. At the beginning of the 1997 tax year, 23 counties asked taxpayers to list intangible assets, such as patents, copyrights, secret processes, formulae, goodwill, trademarks, trade brands, and franchises, on their 1997 business personal property tax form. Before 1997, only a few counties were listing this type of property. Second, a recent case before the North Carolina Court of Appeals, Edward Valves, Inc., highlighted both the potential and the difficulties of taxing intangible personal property. In that case, Wake County levied a property tax on a set of exclusive engineering drawings. The drawings were valued at more than $12 million. The court found that the county's methodology for taxing self-created intangible property was unconstitutional and that it violated the statutory requirement that property taxes be levied uniformly.

The act also clarifies that the exclusion of intangible property from property tax does not affect the appraisal of real property or tangible personal property. One of the most commonly used methods of valuing commercial property is the income approach to value. Under the income approach, the contribution of intangible assets to a business' income is an inherent part of the valuation process. The act will allow counties and cities to continue considering intangible personal property, such as trademarks and goodwill, when they assess other real property and tangible personal property.

The act discourages counties and cities from discovering prior years' taxes on intangible personal property excluded by this act on or after January 1, 1997. It does so by reducing the annual State reimbursement to a county or municipality for the repeal of the intangibles tax on money, accounts receivable, bonds, stock, and beneficial trust interests by the amount of taxes collected in that year on intangible property for a year prior to the 1997 tax year. This part of the act is repealed effective September 1, 2002, because the five-year discovery period will have expired then.

Lastly, the act seeks to preserve the legislature's authority to classify property for taxation by providing a non-severability clause in the current software property tax exemption. If any part of the exemption is ever ruled unconstitutional, then the entire exemption will be defeated. Consequently, all computer software will be subject to property tax unless the General Assembly acts to re-classify it for exemption. In 1994, the General Assembly carefully crafted an across-the-board property tax exemption for all computer software other than embedded software and software that is required by generally accepted accounting principles to be treated as a capital asset. This exemption was the result of a compromise between the North Carolina Association of County Commissioners and a taxpayer group called the North Carolina Software Coalition.

S.L. 1997-55 (House Bill 59, Representative Neely)

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

This act rewrites the definition of the Internal Revenue Code used in State tax statutes to change the reference date from March 20, 1996, to January 1, 1997. It was recommended by the Revenue Laws Study Committee. Updating the Internal Revenue Code reference makes recent amendments to the Code applicable to the State to the extent that State tax law previously tracked federal law. This update generally has the greatest effect on State corporate and individual income taxes because these taxes are based on federal taxable income and are therefore closely tied to federal law. The franchise tax, gift tax, highway use tax, inheritance tax, and insurance company premiums tax also determine some exemptions based on the provisions of the Code.

Congress made significant changes to the Code in 1996 that will affect federal taxable income. Because federal taxable income is the starting point for calculating State corporate and individual income taxes, these federal changes adopted by this act will affect State policies and revenues. The act is expected to reduce General Fund revenues by approximately $8.5 million in 1997-98, $16.8 million in 1998-99, $11.5 million in 1999-2000, $13 million in 2000-01, and $17 million in 2001-02.

The federal Small Business Job Protection Act made two tax changes that will affect the General Fund proportionally more than the other tax changes: the amount of property that may be expensed under Code section 179 is increased from $17,500 to $25,000 over a period of 5 years and the amount a self-employed person may deduct for health insurance costs is increased from 30% to 80% over a period of 10 years. The Small Business Job Protection Act made major changes to the S Corporation rules, introduced a new type of retirement plan (SIMPLE), and narrowed the exclusion for punitive damages received on account of personal injury or sickness. It also created a new adoption credit and exclusion and increased the amount a nonworking spouse could contribute to an IRA.

The federal Health Insurance Portability and Accountability Act created a pilot test program for tax-favored medical savings accounts (MSAs) and added two new exceptions to the 10% penalty for premature withdrawals from IRAs. It provided that costs of long-term care services and some long-term care insurance premiums will be considered medical expenses for itemized deduction purposes. The Health Insurance Portability and Accountability Act also allowed an income tax exclusion for long-term care benefits to chronically ill insureds and extended the income tax exclusion for life insurance death benefits to benefits paid during life to the terminally ill.

This act provides that the federal tax law changes that could increase an individual's or corporation's North Carolina taxable income for the 1996 tax year will not become effective for 1996 tax years but will instead apply only to taxable years beginning on or after January 1, 1997. Under Section 16 of Article 1 of the North Carolina Constitution, the legislature cannot pass a law that will retroactively increase the tax liability of any taxpayer. There are a few provisions in the federal tax law changes that could increase taxable income for the 1996 tax year. Because this act could not be ratified until after the 1997 General Assembly convened, theses changes were given a delayed effective date.

Since the State corporate income tax was changed to a percentage of federal taxable income in 1967, the reference date to the Internal Revenue Code has been updated periodically. In discussing bills to update the Code reference, the question frequently arises as to why the statutes refer to the Code on a particular date instead of referring to the Code and any future amendments to it, thereby eliminating the necessity of bills like this one. The answer to the question lies in both a policy decision and a potential legal restraint.

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

Secondly, and more importantly, however, the North Carolina Constitution imposes an obstacle to a statute that automatically adopts any changes in federal tax law. Section 2(1) of Article V of the Constitution provides in pertinent part that the "power of taxation … shall never be surrendered, suspended, or contracted away." Relying on this provision, on the North Carolina court decisions on delegation of legislative power to administrative agencies, and on 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."

S.L. 1997-60 (Senate Bill 98, Senator Kerr)

AN ACT TO IMPROVE THE ADMINISTRATION OF THE MOTOR FUEL TAX LAWS.

This act makes changes to the method of collecting motor fuel taxes commonly referred to as "tax at the rack", that was enacted by the General Assembly in the 1995 Session and became effective January 1, 1996. The method bears this name because it imposes the per gallon excise tax when motor fuel is delivered to a transport truck or railroad tank car by means of a "rack" at a refinery, terminal, or bulk plant. This act changes the licensing requirements for exporters and makes several conforming changes as described below.

Section 1 of the act ensures that the State's motor fuel tax will be considered a "pass-through" tax, by expressly stating that the tax is collected from the supplier or importer of the fuel but that the tax becomes part of the cost of the fuel and is consequently paid by the consumer. This statutory language was added in order to protect the State from a challenge to its motor fuel tax laws similar to that in the U.S. Supreme Court case of Oklahoma Tax Commission v. Chickasaw Nation (decided June 14, 1995). There the Oklahoma gas tax was held not to apply to Native American retailers because of tribal sovereign immunity, even though the tax was collected by the fuel distributor and passed through the chain of distribution on to the ultimate consumer. The Court emphasized that the Oklahoma statute imposing this tax

did not expressly identify the party that bears the burden of the tax, and more importantly, did not contain a pass-through provision requiring distributors and retailers to pass the tax on to consumers.

Sections 2 and 4 of the act require exporters to be licensed. Under prior law, an exporter could have been but was not required to be licensed. A licensed exporter paid tax at the destination state rate, while an unlicensed exporter had to pay tax at the North Carolina rate. This difference in treatment resulted in the unlicensed exporter paying both the North Carolina tax and the tax of the destination state and then having to apply to North Carolina for a refund. The requirement under this act, that all exporters be licensed, parallels the existing requirement that all importers be licensed.

Section 3 of the act makes the following changes to the importer licensing provisions for a bulk-end user, such as a trucking company:

1. Allows bulk-end users to be bonded importers and thereby buy fuel at an out-of state terminal that does not precollect the North Carolina motor fuel tax. Prior law prohibited a bulk-end user from obtaining a bonded importer license.
2. Relieves bulk-end users of the importer licensing requirement if they buy all their imported fuel at an out-of-state terminal that precollects the North Carolina tax. Prior law required an occasional importer license in this circumstance. This change parallels the existing treatment of distributors, i.e., a distributor that imports only from a terminal that precollects the North Carolina tax is not required to have an importer license.

Section 5 of the act deletes the requirement that an exporter file a bond. This change was made because the act requires all exporters to be licensed. The purpose of licensing is primarily to track cross-border shipments of fuel, and the bonding requirement is not necessary for this purpose. Prior law required an exporter who chose to be licensed to pay a bond or provide an irrevocable letter of credit in an amount not less than $2,000 or more than $250,000.

Section 6 of the act deletes all references to unlicensed exporters, since sections 2 and 4 of the act require all exporters to be licensed.

Section 7 of the act imposes potential liability on an unlicensed exporter for the North Carolina tax on the fuel exported. If an unlicensed exporter buys fuel, the Department of Revenue can assess tax on the fuel purchased at the North Carolina rate.

Sections 8 and 22 of the act reduce the marking requirements for dyed diesel storage tanks so that they only apply to a person who is a retailer of dyed diesel fuel or who stores both dyed fuel and undyed diesel fuel for use by that person or another person. Prior law required all dyed diesel storage tanks to be labeled "For Nonhighway Use" unless the fuel in the tank was for home heating, drying crops, or manufacturing and the tank was installed so that use of the fuel for any other purpose was made improbable.

Section 9 of the act clarifies the tax liability concerning the use of exempt cards and exempt access codes. A supplier is not liable for any tax due on fuel sold to a distributor or importer who represented that the fuel would be resold to an exempt governmental entity but who did not resell the fuel to a tax-exempt entity. Distributors and importers make this representation by using a card or access code issued by the supplier when getting the fuel at the terminal, and this card or code allows the distributor or importer to buy the fuel tax-free. If a distributor or importer in this circumstance sells tax-free fuel to a person who is not exempt,

the distributor or importer is liable for any tax due on the fuel. The act also makes clear that a supplier that issues a card or code, enabling a person to buy fuel at retail without being charged the tax already paid on the fuel, has a duty to determine if the person is actually tax-exempt. A supplier is responsible for any tax due if the person to whom the supplier issued the card is not an exempt entity.

Section 10 of the act requires an out-of-state bulk-end user that buys fuel at a North Carolina terminal, as opposed to a bulk plant, to be licensed as a distributor or exporter. This change accompanies the changes made by Sections 2 and 4 of the act that require all exporters to be licensed. Unless the bulk-end user falls within the grandfather group of users that can get distributor licenses, the user will need to be licensed as an exporter.

Section 11 of the act changes the due date of a tax return of an occasional importer from the first of each month to the third of each month. This change was made at the request of sellers of racing gasoline who pointed out that if they buy fuel on the last day of a month it is difficult to prepare the return and send it in the next day. G.S. 105-449.66 defines an "occasional importer" as any of the following that imports motor fuel by any means outside the terminal transfer system:

1. A distributor that imports motor fuel on an average basis of no more than once a month during a calendar year.
2. A bulk-end user that is not a distributor.
3. A distributor that imports motor fuel for use in a race car.

Section 12 of the act deletes references to unlicensed exporters.

Section 13 of the act deletes references to an exporter.

Section 14 of the act adds imports to the categories of information contained on a supplier's return. It does this by replacing references to specific license holders in some places with the generic reference to "person receiving the fuel" and by adding references to "importer" in others.

Section 15 of the act allows a supplier to take a deduction on the supplier's return for taxes paid by the supplier on fuel that was subsequently sold at retail to a person who is exempt from tax and who used a card issued by the supplier to indicate his or her tax-exempt status when buying the fuel.

Section 16 of the act adds importers to the groups of license holders that must receive certain information from suppliers and about whom the suppliers must notify the Department of Revenue.

Section 17 of the act clarifies that anyone who pays tax on fuel that is exempt from tax can apply for a refund of the tax paid.

Section 18 of the act adds a civil penalty for failure to get an importer confirmation number. The penalty is the same as the penalty for transporting motor fuel without a shipping document or with a false or incomplete document or for delivering motor fuel to a destination state other than as shown on the document. Prior law contained no penalty.

Section 19 of the act clarifies that the penalty for using dyed diesel or other non-tax-paid fuel in a highway vehicle applies to all fuel used in the vehicle. Prior law applied the penalty to fuel used "for highway use". This language could have been construed to mean

that a vehicle that is parked at a rest area or the parking lot of a business and that had dyed diesel in its tanks was not subject to the penalty, because the fuel was not at that moment being used for a highway use.

Section 20 of the act clarifies that failure to pay a tax under the prior motor fuel tax laws is to be treated the same as a failure to pay under the revised laws. When tax at the rack was implemented, the existing motor fuel tax laws were repealed and replaced by the new provisions. Many assessments for taxes owed under the prior laws have not been paid.

Section 23 of the act requires a retailer or bulk user of alternative fuel that will be the taxpayer for the fuel to file a bond or irrevocable letter of credit with the Secretary of Revenue.

Section 24 of the act changes when the liability for tax on certain alternative fuel accrues. The section allows those retailers and users that use the same storage tank for highway and nonhighway alternative fuel to pay tax on the highway alternative fuel when it is metered from the tank. Prior law required taxes on alternative fuel to be paid when the fuel was delivered to the retailer of the fuel or the bulk user of the fuel. This created a problem when alternative fuel was used for a dual purpose, since the provider of the fuel did not know how much fuel would be used for a highway purpose when the fuel was delivered to the retailer or user.

Section 25 of the act allows retailers and bulk-end users of alternative fuel to store the fuel in a tank that holds both highway and nonhighway alternative fuel if the tank has separate metering devices to measure the fuel that is used for a highway use and fuel that is used for some other purpose.

All sections of the act, except three clarifying changes, became effective October 1, 1997. The clarifying changes became effective when the act became law (May 16, 1997).

S.L. 1997-77 (House Bill 36, Representative Capps)

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

This act was a recommendation of the Revenue Laws Study Committee. It establishes an annual filing period for the payment of use taxes owed by consumers on mail-order and other out-of-State purchases. The annual filing period relieves consumers of the need to file either monthly or quarterly returns. The act became effective May 15, 1997, and applies to purchases made on or after January 1, 1997.

In 1991, the Department of Revenue began including an annual use tax return (Form E-554) on the individual income tax booklets. Under the State sales and use tax law, a person is responsible for paying use tax on their out-of-state purchases. Prior law specified only two reporting periods – a quarterly period if the tax owed was less than $50.00, and a monthly period if the tax owed was more. Arguably, therefore, North Carolina customers of mail-order catalog companies should have been filing either monthly or quarterly returns.

The act improves the collection of the use tax by minimizing the compliance burden. Individuals who owe use tax on goods purchased out-of-state for a non-business purpose are now able to file an annual return. The return and the tax are due at the same time as the individual income tax return. In theory, residents who are subject to use tax for out-of-state purchases are more likely to comply if the reporting and payment procedure is not unduly burdensome.

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

The most cost-effective manner to collect the tax, from a state's point-of-view, is to require the out-of-state retailers to collect and remit the use tax. However, in 1967, the U.S. Supreme Court ruled in Bellas Hess that a state cannot require an out-of-state retailer to collect its use tax unless the retailer has enough contacts with the state to subject it to the state's taxing jurisdiction. The Supreme Court reaffirmed this decision in 1992 in Quill Company v. North Dakota.

The Direct Marketers Association, the Federation of Tax Administrators, the Multi-state Tax Commission, and the National Governors' Association have been negotiating a possible agreement under which more direct marketers would voluntarily collect use tax on behalf of customers in states in which the marketers do not have nexus. The group is likely to have a final agreement by July 1, 1998. If a final proposed agreement is reached, it will then be up to the states and the marketers to enter into the agreement.

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

S.L. 1997-109 (House Bill 57, Representative Neely)

AN ACT TO REQUIRE WITHHOLDING FROM CERTAIN PAYMENTS TO NONRESIDENTS IN ORDER TO PREVENT NONRESIDENTS FROM AVOIDING NORTH CAROLINA INCOME TAXES, TO MODIFY THE DEFINITION OF EMPLOYMENT WITH RESPECT TO AGRICULTURAL LABOR, AND TO CONFORM TO FEDERAL RULES ON WAGE WITHHOLDING BY FARMERS.

This act makes two changes concerning the collection of taxes owed to North Carolina. First, it requires withholding from compensation paid to nonresident individuals and nonresident entities for personal services performed in North Carolina. Second, it conforms State law to the federal law regarding agricultural employees' wages (both withholding from the wages and unemployment insurance tax on the wages).

The changes made by the act become effective at different times. The requirement to withhold from compensation paid to nonresident individuals and from compensation for athletic, entertainment, and construction services paid to nonresident partnerships, corporations, or limited liability companies becomes effective January 1, 1998. The requirement to withhold from all other compensation paid to these nonresident entities for personal services becomes effective January 1, 1999. This phase in of the withholding requirement was requested by North Carolina Citizens for Business and Industry. The nonresident withholding provisions of the act were suggested by the Department of Revenue and recommended by the Revenue Laws Study Committee. It is anticipated that the collection of income taxes owed by nonresident companies and individuals to the State will increase by $8 to $10 million a year as a result of these

provisions.

The requirement to withhold from agricultural wages to the same extent as is required under federal law becomes effective January 1, 1998. Conformity to the federal unemployment tax exemption for certain aliens performing agricultural labor, as requested by the Farm Bureau, becomes effective immediately.

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

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

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

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

Under this act, a person or entity who, in the course of a trade or business, pays a nonresident more than $600 for personal services in this State will be required to withhold 4% of the payment and deposit the withheld taxes with the Department of Revenue. The withholding agent must register with the Department of Revenue. The withheld taxes are due by the last day of the first month after the end of the calendar quarter in which the withholding agent paid the nonresident. As is the case with employers who withhold from employees' wages, the withholding agent will be required to give each nonresident a statement similar to a W-2 form in January and to provide a compilation of these statements to the Department of Revenue. Filing these documents relieves the agent of the existing information reporting requirement of G.S. 105-154.

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

A number of other states have instituted withholding programs and special audit programs to close the loophole that allows nonresidents to avoid paying state income taxes

they owe. California, Connecticut, Minnesota, New Jersey, and South Carolina have withholding requirements. Michigan, Missouri, and New York have special audit programs.

S.L. 1997-111 (House Bill 474, Representative Sutton)

AN ACT TO CLARIFY WHICH PREINDUCEMENT EXPENDITURES MAY BE FINANCED WITH INDUSTRIAL REVENUE BONDS.

This act clarifies the Department of Commerce's current policy of what costs may be reimbursed with Industrial Revenue Bond proceeds. The policy is derived from federal tax law. Under federal law, two types of expenditures may be reimbursed from bond proceeds:

1. An expenditure that is incurred or paid within 60 days of the date the Financing Authority took some action indicating its intent that the expenditure would be financed or reimbursed from bond proceeds.
2. Incidental expenditures that are incurred prior to the commencement of the acquisition, construction, or rehabilitation of a project. Examples of this type of expenditure include architectural costs, engineering costs, surveying costs, soil testing costs, and bond issuance costs.

Industrial Revenue Bonds offer manufacturing companies long-term debt financing at interest rates substantially below the current prime rate. Under the program, a local Financing Authority may enter into a financing agreement with a company to provide revenue bond proceeds to the company to be used to finance capital expenditures, such as fixed assets, land, buildings, new equipment, existing equipment, etc. The amounts payable by the company to the authority under the financing agreement must be sufficient to pay all of the principal and interest on the bonds.

Bond proceeds cannot be used to refinance existing debt or as venture capital. Current law does not define the term "refinance." Under federal law, bond proceeds may be used to reimburse certain expenses the company incurs prior to any action of the authority indicating its intent that the expenditure would be financed or reimbursed from bond proceeds. This act allows North Carolina the full flexibility available under federal law to reimburse certain preinducement expenditures.

S.L. 1997-118 (Senate Bill 34, Senator Cochrane)

AN ACT TO ADJUST THE SHARE THE CITIES RECEIVE FROM THE STATE GROSS RECEIPTS TAX TO MAKE THE DISTRIBUTION MORE EQUITABLE AND TO ALLOW THE DEPARTMENT OF REVENUE TO GIVE CITY FINANCE OFFICIALS INFORMATION NEEDED TO VERIFY THE ACCURACY OF A CITY'S DISTRIBUTION.

This act increases the amount of State franchise tax that is distributed to 40 cities. The cities whose distributions are increased are those whose 1995-96 distributions were less than 95% of their 1990-91 distributions. The act increases the distributions for these cities by reducing the “hold-back amount” that is deducted from a city’s share. The act applies to distributions made for fiscal year 1995-96 and subsequent years. The act increases the annual distribution to the affected cities by a total of $194,841. The annual distribution to the other 500 cities is reduced by the same amount, so that the State share of the franchise tax is not reduced under this act. This act was recommended by the Revenue Laws Study Committee.

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

The amount to be distributed to a city is reduced by that city's "hold-back" amount. The "hold-back" amount is the amount by which the city's distribution of these franchise taxes increased from fiscal year 1990-91 to fiscal year 1994-95. During this period, the total amount distributed was frozen but the relative share of each city changed based on the proportion of that city's receipts compared to the total of all cities' receipts. When the freeze was lifted in 1995-96, a requirement was imposed to calculate and deduct a "hold-back" amount. The effect of the deduction of a hold-back amount from the cities' distribution is the retention by the State of the growth that occurred in the franchise tax base during the freeze years. The hold-back amount is considered the cities' contribution to the State budget crisis in the early 1990s.

The "hold-back" amount reduced the amount distributed in fiscal year 1995-96 to some cities below the amount that was distributed to them in 1990-91. This occurred to cities that experienced a temporary franchise tax base growth in the freeze years (1990-91 through 1994-95) and then a reduction of the base in 1995-96. The hold-back deduction requires these cities to deduct taxes attributable to growth that is no longer in their tax base.

The act adjusts for this loss of tax base growth by reducing the hold-back amount. The amount distributed to a city in 1995-96 is compared to the amount distributed in 1990-91. If the 1995-96 amount is less than 95% of the 1990-91 amount, the hold-back amount is reduced in accordance with the formula in the act to the greater of zero or the amount that would have caused the city's 1995-96 distribution to equal the 1990-91 amount.

In the course of developing this proposal, a number of reporting errors from utilities were discovered. To address this concern, the act amends the tax secrecy provisions to allow the Department of Revenue to give finance officials of a city a list of the utility taxable gross receipts that were derived from sales within the city and used to determine the franchise tax distribution to the city. This provision will allow cities to verify the data that determines their share of the State franchise tax distribution.

S.L. 1997-121 (Senate Bill 106, Senator Cooper)

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

This act gives the Department of Revenue the ability to sell in any county in this State personal property the Department has seized for payment of delinquent State taxes. Current law requires this property to be sold in Wake County or the county in which the property was seized. It was recommended to the 1997 General Assembly by the Revenue Laws Study Committee.

G.S. 105-242(a)(2) authorizes the Secretary of Revenue to levy on a taxpayer's personal property to collect delinquent unpaid taxes and to sell the property either in Wake County or in the county in which it was seized. This statute is used almost exclusively by the Controlled Substance Tax Division, which collects the tax on illegal drugs. The 1997 General Assembly expanded the tax on illegal drugs to include a tax on illegal liquor. Vehicles and other property are often seized for these taxes pursuant to G.S. 105-113.111 and sold at

auction. Seventy-five percent of the proceeds of these sales are distributed among the law enforcement agencies whose investigation led to the assessment and the remaining 25% is credited to the General Fund.

The current practice of the Department is to store and sell all seized property in Wake County. The Department does this because it is too costly to store and sell property in all 100 counties. The Department contracts to have seized property hauled from the counties in which it is seized to Wake County where it is stored until an auction site is available. Rental of auction sites in Wake County is expensive and, because of delays due to waiting for a site, the Department incurs extra costs for storing the property.

The Department plans to implement this act by establishing regional sites in Eastern, Central, and Western North Carolina for the sale of seized property. Expanding the permissible locations for sales will reduce costs because the property will not have to be hauled as far and there will be less storage time waiting for an auction site to become available. In addition, more companies will be able to compete for the transportation, storage, and sale business because they will no longer have to have Statewide operations in order to qualify, and this increase in competition could yield a lower contract price. The Department estimates that it will be able to reduce expenses incurred in selling seized property by at least $39,000 a year.

S.L. 1997-139 (Senate Bill 323, Senator Horton)

AN ACT TO ALLOW AN INCOME TAX CREDIT FOR EXPENDITURES TO REHABILITATE HISTORIC STRUCTURES.

This act expands the current State income tax credit for rehabilitating an income-producing historic structure, effective beginning in the 1998 tax year. It is expected to reduce General Fund revenues by approximately $56,000 in 1998-99, $965,000 in 1999-2000, $2 million in 2000-01, and $3.5 million in 2001-02.

The act increases the credit for rehabilitating income-producing structures from 5% to 20% of the rehabilitating expenditures and allows a new 30% credit for rehabilitating non-income producing structures. The 20% credit will yield a combined federal and State credit equal to 40% of the rehabilitating expenditures for income-producing historic structures. A taxpayer is allowed the 30% State tax credit for rehabilitating non-income producing historic residential structures only if the taxpayer does not qualify for the federal tax credit for income-producing historic structures.

The act also provides that the credits may not be taken in one year but must be spread out in installments over five years after the historic structure is placed in service. Any unused portion of a credit may be carried forward for a five-year period.

Federal law provides a federal income tax credit equal to 20% of qualified rehabilitation expenditures for certified historic structures that are used in connection with a trade or business or held for the production of income. This credit is available for both residential rental buildings and nonresidential buildings that are listed in the National Register or that are located in a registered historic district and certified as being of historic significance. Former State tax law provided an individual and corporate income tax credit for rehabilitating a certified historic structure for which the taxpayer was allowed a credit under federal law if the historic structure was located in North Carolina. Federal tax law does not provide an income tax credit for rehabilitating an historic structure that is used as the owner's residence and thus is not income-producing. This act expands the existing State credit to include certified historic

structures that are not otherwise eligible for the federal tax credit because they are not income-producing. To be eligible for the credit for rehabilitating a non-income producing historic structure, a taxpayer must attach a copy of the certification received from the State Historic Preservation Office verifying that the improvements made are consistent with the Secretary of the Interior's Standards for Rehabilitation. In addition, the costs of the improvements must exceed $25,000 over a 24-month period.

S.L. 1997-205 (Senate Bill 1064, Senator Hoyle)

AN ACT TO ALLOW A TAXPAYER WHO PREVAILS IN A PROPERTY TAX APPEAL TO RECEIVE INTEREST ON ANY OVERPAYMENT OF TAX AND TO AUTHORIZE THE LEGISLATIVE RESEARCH COMMISSION TO STUDY VARIOUS PROPERTY TAX ISSUES.

This act allows a taxpayer who has prevailed in a property tax appeal to receive interest on the overpayment of property taxes, effective for appeals made to the Property Tax Commission on or after July 1, 1997. The Property Tax Commission hears and decides appeals from decisions concerning the listing, appraisal, or assessment of property made by county boards of equalization and review and boards of county commissioners. Any property owner who is dissatisfied with the decisions of these county boards may appeal to the Commission. Under prior law, if the Property Tax Commission determined that a taxpayer's property had been overvalued and that the taxpayer had therefore paid more tax than was owed on the property, there was no payment of interest on the overpayment. The act provides that the overpayment will bear interest at the rate borne by all other assessments of tax. Under current law this rate is determined in accordance with G.S. 105-241.1(i). The statute permits the Secretary of Revenue to set interest paid on State taxes semiannually after giving due consideration to current market conditions and to the rate that will be in effect on that date pursuant to the Internal Revenue Code.

The act authorizes the Legislative Research Commission to study methods used by counties to develop the schedules of value for a general reappraisal of real property, the process for appealing the value or listing of property, and the octennial revaluation schedule. In conducting this study, the Commission may determine whether the procedures used in developing schedules of value produce unrealistic values on nonresidential real property, whether representatives of the Department of Revenue should be given more authority in resolving taxpayer appeals, and whether the Property Tax Commission should be replaced with a State Tax Court. The Commission may assign these property tax issues to a tax study committee or create a separate study committee to study these issues. The Commission may make an interim report of its findings to the 1998 Regular Session of the 1997 General Assembly and a final report to the 1999 General Assembly.

S.L. 1997-209 (Senate Bill 153, Senator Odom)

AN ACT TO EXTEND THE SCRAP TIRE DISPOSAL TAX AT ITS CURRENT RATE FOR FIVE MORE YEARS, TO AMEND THE SCRAP TIRE DISPOSAL ACT TO DISCOURAGE THE DISPOSAL OF SCRAP TIRES FROM OUTSIDE THE STATE, AND TO COMPLETE THE CLEANUP OF NUISANCE TIRE COLLECTION SITES, AS RECOMMENDED BY THE ENVIRONMENTAL REVIEW COMMISSION.

This act makes a number of changes to the scrap tire tax and the use of the tax proceeds. It was recommended by the Environmental Review Commission. The scrap tire disposal tax was

enacted in 1989 and applies to tires sold at retail and tires sold for placement on vehicles to be sold or leased at retail. The tax generates almost $10 million a year in revenue.

The act moves the sunset date on the 1993 increase in the tax from June 30, 1997, to June 30, 2002. Therefore, the 1993 tax increase will expire five years later than it would have if this act had not been enacted. Effective October 1, 1993, the tax rate was increased from 1% to 2% for tires with a bead diameter of less than 20 inches. Bead width is the width of the inside opening of the tire. Tires for cars, vans, and pick-up trucks have a bead width of less than 20 inches. When the tax increase sunsets, the tax on these tires will revert back to 1%.

The scrap tire tax proceeds are distributed as follows: 27% to the Scrap Tire Disposal Account, 5% to the Solid Waste Management Trust Fund, and 68% to the counties on a per capita basis. This act repeals a provision that, effective June 30, 1997, would have sunset the Scrap Tire Disposal Account and discontinued the 27% earmarking to the Account, increased from 5% to 10% the earmarking to the Solid Waste Management Trust Fund, and increased from 68% to 90% the percentage distributed to counties.

The act increases from 25% to 50% the maximum amount in the Scrap Tire Disposal Account that may be used for grants to local governments to assist in the disposal of scrap tires, and allows up to 40% of the amount in the Account to be used for grants to encourage the use of processed scrap tire materials. The remaining funds in the Account will continue to be used to clean up nuisance scrap tire collection sites. Under prior law, the Department of Environment and Natural Resources (DENR) could use up to 25% of the funds in this Account to make grants to counties for scrap tire disposal and was required to use the remaining funds in the Account to clean up nuisance scrap tire collection sites.

The act adds a factor for DENR to consider when making grants to local units from the Scrap Tire Disposal Account to assist them in disposing of scrap tires. That factor is the effort made by the local unit to prevent out-of-state tires from being disposed of for free. G.S. 130A-309.58(e) prohibits counties from charging a fee for scrap tire disposal unless the tires are defective new tires or tires that have a certificate indicating they came from outside the State and therefore were not replacements for tires on which the scrap tire tax was paid. Despite the certificate requirement, many out-of-state tires are being disposed of for free in this State's disposal sites.

S.L. 1997-213 (House Bill 15, Representative Cansler)

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

This act conforms North Carolina's income tax law to the Internal Revenue Code with respect to the tax treatment of "restored income." Restored income is $3,000 or more of income that a taxpayer receives from a person in one year but then has to pay back in a later year. It was recommended by the Revenue Laws Study Committee. The act applies retroactively to the 1995 tax year to address a specific situation that was brought to the attention of the Revenue Laws Study Committee.

A taxpayer may receive a substantial amount of income in year one and pay tax on the income for that year. Then, in year two, for example, the taxpayer may be required to pay back some of the income that was received in year one and taxed. If this occurs and the amount given back is at least $3,000, the taxpayer may deduct in year two the amount of income that was paid back. The deduction in year two of the "restored" income offsets the inclusion of the

income in year one if the taxpayer's income in year two is large enough to be able to take the deduction.

If the taxpayer's income in year two is smaller than the amount to be deducted, the taxpayer is in the position of having paid taxes on income that, as it turns out, did not belong to the taxpayer. Even with individual net loss deductions, the taxpayer may never have enough income to deduct the amount the taxpayer had to pay back. The taxpayer is not allowed to file an amended return for year one to subtract the restored income because the taxpayer did in fact receive the income in year one. If the taxpayer had restored the income in year one rather than year two, however, the two events would have offset one another and there would have been no tax consequence.

For federal purposes, the Internal Revenue Code provides relief in these cases if the amount restored is at least $3,000 and there is insufficient income in the later year to offset the deduction and thus reduce the taxpayer's tax by the amount it was increased in year one because of the inclusion of the restored amount. Section 1341 of the Code gives the taxpayer, in effect, instead of a deduction in year two, a credit for the amount by which the taxpayer's tax would have been reduced in year one if the restored amount had not been included in taxable income for that year. The credit is treated as a payment of tax made by the taxpayer, which can then be refunded.

North Carolina's individual and corporate income taxes piggyback the federal Code to a large extent but, under prior law, did not conform to section 1341 because that section is structured as an alternative tax rather than as a reduction in taxable income. Because there was no corresponding provision in the North Carolina income tax law, a taxpayer would end up paying North Carolina income tax on income the taxpayer later had to repay to another. This act conforms the North Carolina law to the federal on this issue by allowing the excess tax paid to be refunded.

The circumstances addressed by this act are rare and its fiscal impact is minimal. The situation sometimes occurs with taxpayers who receive employer disability payments while an application for federal disability payments is pending. A federal disability application may take a year or two to process and, if federal benefits are approved retroactively, the taxpayer is usually required to pay back to the employer the amount of employer disability payments received while the federal case was pending.

The case that was brought to the attention of the Revenue Laws Study Committee involved an individual who invented a formula for producing a chemical product and sold the formula to a manufacturer for nearly $2 million in 1994. The inventor's former employer sued the inventor claiming that the employer had licensing rights to the formula. The inventor settled the suit by paying the employer more than $400,000 of the $2 million sales proceeds in 1995. The inventor paid tax on the full $2 million in 1994; in 1995, the inventor had little income to offset the $400,000 deduction for the amount restored to the employer. Thus, without this act, the inventor would have forfeited the more than $25,000 in North Carolina income tax paid on the remainder of the $400,000 in 1994.

S.L. 1997-226 (House Bill 260, Representative Gray)

AN ACT TO INCREASE THE CAP ON THE INCOME TAX CREDIT FOR REAL PROPERTY DONATED FOR CONSERVATION PURPOSES, TO ENSURE THAT CONSERVATION AND PRESERVATION AGREEMENTS ARE CONSIDERED IN DETERMINING THE APPRAISED

VALUE OF LAND AND IMPROVEMENTS, AND TO ESTABLISH THE CONSERVATION GRANT FUND.

This act directs the Department of Environment and Natural Resources (DENR) to develop a program to encourage a Statewide network of protected natural areas, riparian buffers, and greenways. The success of the program lies in the voluntary donation by property owners of conservation easements in land that is important to the ecological system of the State. A conservation easement is a written agreement between a landowner and a qualifying conservation organization or public agency. The landowner agrees to keep the property covered by the easement in its natural condition, without extensive disturbance. The organization or agency is granted the right to enforce the covenants of the easement and to monitor the property.

The act provides two different methods of carrying out its purpose. First, it increases the tax credit for certain real property donations where the land is useful for land conservation purposes. Second, it creates a Conservation Grant Fund to stimulate the use of conservation easements, to improve the capacity of private nonprofit land trusts to successfully accomplish conservation projects, to better equip real estate related professionals to pursue opportunities for conservation, to increase citizen participation in land and water conservation, and to provide an opportunity to leverage private and other public monies for conservation easements. The fiscal impact of the act from the increase in tax credits is estimated to be a loss of $3.2 million a year. The increase in tax credits was effective beginning on or after January 1, 1997. The Conservation Easements Fund became effective July 1, 1997.

Under prior law, a taxpayer could receive a tax credit equal to 25% of the fair market value of a property interest donated to the State, a unit of local government, or a body organized to receive and administer lands for conservation purposes. The act increases the $25,000 cap on this credit to $100,000 for individual income taxes and $250,000 for corporate income taxes.

The act also makes a conforming change to ensure that a taxpayer who chooses to claim the State credit does not also claim and receive a deduction for federal income tax purposes. This is necessary since federal taxable income is the starting point for calculating State taxable income.

The act further provides that county property tax assessors shall take into account changes in the property's value resulting from conservation or preservation agreements.

The act directs DENR to develop a nonregulatory program, known as the Conservation Easements Program, that uses conservation tax credits as a prominent tool to accomplish conservation purposes and that creates the Conservation Grant Fund to be administered by DENR. Grants from the Fund may be used only to pay for one or more of the following costs and may not be used to pay the purchase price for any interest in land:

1. Reimbursement for all or part of the transaction costs associated with a donation of property.
2. Management support.
3. Monitoring compliance with conservation easements, the related use of riparian buffers, natural areas, and greenways, and the presence of ecological integrity.
4. Educational materials that will encourage conservation purposes.
5. Stewardship of land.

6. Transaction costs, including legal expenses, closing and title costs, and unusual direct costs, such as overnight travel.
7. Administrative costs for short-term growth or for building capacity.

The grant money under the Conservation Grant Fund is available for land that possesses or has a high potential to possess ecological value, is reasonably restorable, and qualifies for the conservation tax credits. A private nonprofit land trust organization is eligible for grant money if it qualifies for the conservation tax credits and is certified under section 501(c)(3) of the Internal Revenue Code.

The Conservation Grant Fund consists of any monies appropriated from the General Fund and any monies received from public or private sources. Any unspent General Fund money appropriated to the Fund reverts at the end of the fiscal year unless the General Assembly provides otherwise. Unexpended monies in the Fund from other sources do not revert at the end of the fiscal year. No money was appropriated to the Fund by this act, nor was any money appropriated in the 1997 General Assembly's budget bill.

S.L. 1997-270 (House Bill 529, Representative Clary)

AN ACT TO PROVIDE THAT DEFERRED TAXES DUE ON CERTAIN PROPERTY THAT IS TAXED AT ITS PRESENT-USE VALUE WILL BE PAID BY THE PERSON TO WHOM THE LAND IS TRANSFERRED IF THE PROPERTY IS TRANSFERRED BECAUSE OF CONDEMNATION.

This act provides that when the State or a local government or a private condemnor condemns property that qualifies for farm use value taxation, the condemnor must reimburse the owner for deferred property taxes owed on the property if the owner is a natural person and has other property that qualifies for farm use value taxation. The act become effective August 1, 1997.

Before its enactment, an earlier version of the bill made the condemnor liable for paying the deferred taxes directly to the taxing unit, but this requirement was changed to a reimbursement requirement because government entities -- most condemnors -- cannot be taxed under the Constitution. They can, however, be required to reimburse the taxpayer.

The act does not impose a reimbursement requirement on the federal government. Federal law governs federal condemnation and cannot be amended by the State.

It has been pointed out that this act, with or without the technical amendment, may create more litigation. Condemnors may argue that the amount of compensation paid should be reduced to reflect the requirement that they reimburse the owner for the deferred taxes. Because of this requirement, the fair market value is arguably lower than it would otherwise be. If this argument were to prevail, the financial burden would be shifted back to the farmer.

Property tax law provides that all property is to be taxed at its market value. A special use value law makes an exception for agricultural land, horticultural land, and forestland: it can be taxed at its value in its current use. The additional property taxes that would otherwise have been due are deferred and become a lien on the land, however. If the use value property is transferred or otherwise becomes ineligible for use value taxation, three years of these deferred taxes become due and payable to the local government taxing units.

The power of eminent domain is the power of a public or private entity to take any interest in property from the owner of the property against the owner's will upon the payment of just compensation for the interest. Condemnation is the procedure for exercising the power

of eminent domain: the condemnor files a court action to determine the condemnor's right to condemn the property and the amount of just compensation to be paid the owner. A condemnor may negotiate with the owner to purchase the property it would otherwise condemn.

The following entities have the power of eminent domain: the State, the federal government, counties, cities, school districts, certain other local government entities, and certain private entities, including public utility companies, private educational institutions (to the extent necessary to obtain a water supply for the institution), and railroad companies. The Department of Transportation and other State agencies benefit from the "quick take" procedure in Article 9 of Chapter 136 of the General Statutes, in which title vests in the condemnor when the condemnation proceeding is instituted. Depending upon the purpose for which a local government entity seeks to condemn property, G.S. 40A-42 provides that the title may vest in the condemnor when the proceeding is instituted or when the property owner fails to contest the authority of the condemnor to condemn the property. In the case of a private condemnor, G.S. 40A-42 provides that title vests in the condemnor only after final resolution of the condemnation proceeding. Under current law, the condemnor is required to reimburse the owner for property taxes allocable to the period after title vests in the condemnor; this would not include the taxes deferred for earlier tax years because the property was taxed at use value rather than market value.

S.L. 1997-272 (Senate Bill 508, Senator Plyler)

AN ACT TO PROVIDE THAT A TURKEY GROWER SHALL NOT BE DISQUALIFIED FROM USE VALUE TAXATION FOR A TWO-YEAR PERIOD IF THE GROWER'S LAND IS TAKEN OUT OF PRODUCTION SOLELY BECAUSE OF THE PRESENCE OF TURKEY DISEASE IN THE AREA.

This act allows agricultural land used in the production of turkey growing within the preceding two years to continue to qualify for present-use value for property tax purposes, even if the property has been taken out production because of an infectious, transmissible disease known as Poult Enteritis-Mortality Syndrome. This disease is characterized by growth depression and high mortality among turkeys. To eradicate the disease, turkey farmers must suspend their production of turkeys. The act is effective for taxes imposed for taxable years beginning on or after July 1, 1997.

Many turkey farmers participate in the use value deferment program. Under this program, agricultural land, forestland, and horticultural land are valued for property tax purposes based upon their present use value rather than fair market value. The difference between the taxes due on the property's use value and its fair market value is deferred until the property loses its eligibility for the program. At that time, taxes for the preceding three fiscal years which have been deferred, together with interest which accrues on the deferred taxes as if they had been payable on the dates on which they originally became due, become immediately due and payable.

To qualify for use value treatment, property must meet certain ownership, use, and income requirements. Besides being individually owned, agricultural land must be in actual production and it must have produced an average gross income of at least $1,000 for the three years preceding January 1 of the year for which the tax benefit is claimed. When turkey farmers must suspend their production of turkeys in an effort to eradicate the disease, they may lose their eligibility for the use value deferment program because the land is no longer in actual production or because the agricultural income is reduced below the $1,000 threshold. This act provides that these farmers will not lose their eligibility for the program solely on the grounds

that the land is being held out of production for the purposes of eradicating the disease of Poult Enteritis-Mortality Syndrome. This exception, however, lasts for only two years. The two-year period should allow farmers to remain in the use value deferment program until they recover.

S.L. 1997-277 (Senate Bill 316, Senator Kerr)

AN ACT TO AMEND THE WILLIAM S. LEE QUALITY JOBS AND BUSINESS EXPANSION ACT.

This act began as an agency bill requested by the North Carolina Department of Commerce. It amends several of the business tax credits that were expanded or enacted by the 1996 General Assembly. As part of the 1996 William S. Lee Quality Jobs and Business Expansion Act, the General Assembly extended the jobs tax credit to all 100 counties, enacted a new tax credit for worker training expenses, enacted a new tax credit for increasing research activities, and enacted two new tax credits for investing in machinery and equipment. To be eligible for the jobs credit, the worker training expense credit, the credit for research activities, and one of the investment credits, the taxpayer had to be engaged in manufacturing or processing, warehousing or distributing, or data processing and the wages of the jobs affected had to be at least 10% above the average weekly wage in the county where the job was created or the business claiming the credit was located, as appropriate.

This act expands the types of businesses eligible for the credits to include air courier services, effective January 1, 1998. Air courier services are businesses primarily engaged in furnishing over-night delivery of individually addressed letters, parcels, and packages. Examples of air courier services include UPS and Federal Express.

This act expands the types of businesses eligible for the credits to include central administrative offices, effective October 1, 1997. Central administrative offices are businesses engaged in providing management and general administrative functions for other businesses of the same enterprise. They may perform such services as general management, accounting, computing, tabulating, or data processing, purchasing, engineering and systems planning, advertising, public relations or lobbying, and legal, financial, or related managerial functions. For a business to qualify for these credits as a central administrative office, it must create at least 40 new full time jobs (not including jobs transferred from elsewhere in the State).

The act also creates a new tax credit for taxpayers who purchase or lease real property to be used as central administrative office property, effective October 1, 1997. The amount of the credit is equal to 7% of the eligible investment amount. The eligible investment is the lesser of: (1) the cost of the property or (2) the cost of the taxpayer's total North Carolina property used as central administrative offices on the last day of the taxable year minus the cost of the taxpayer's total North Carolina property used as central administrative offices on the last day of the base year. The base year is that year, of the three immediately preceding taxable years, in which the taxpayer was using the most property as central administrative offices in this State. This calculation prevents a taxpayer from receiving a credit for an office moved from one part of the State to another. For leased property, the cost of the property equals the lease payments over a seven-year period, plus any expenditures made by the taxpayer to improve the property before it is used as the taxpayer's central administrative office if the expenditures are not reimbursed or credited by the lessor. The tax credit for investing in central administrative office property may not exceed $500,000, and is taken in seven equal installments over the seven years following the taxable year in which the property is first used as a central administrative office. If the property ceases to be used as a central administrative office during the seven-year period, then the credit expires and the taxpayer may not take any remaining

installment of the credit. The credit also expires if the total number of the taxpayer's employees at all of its central administrative offices drops by 40 or more.

The act expands the credit for investing in machinery and equipment and the business property credit to include leased personal property. This change is effective for taxable years beginning on or after January 1, 1997.

The act changes the formula for determining a county's ranking and tier designation for several of the tax credits in two ways. First, it changes the factors in the formula. Under prior law, the Secretary of Commerce assigned an enterprise factor to each county each year based on the county's rank in a ranking of counties by unemployment (from lowest to highest), by per capita income (from highest to lowest), and by population growth (from highest to lowest). The act changes the unemployment and per capita income components from a one-year standing to a standing based on the average of the most recent three years. Second, the act guarantees that a county that obtains Tier 1 status cannot lose that status for two years regardless of what the annual rankings would otherwise require. The first of these changes is effective when the act becomes law and applies to designations for the 1998 and later calendar years. The guarantee of at least a two-year Tier 1 status applies retroactively to 1997 and subsequent years.

The act changes the wage standard that applies to all but one of the investment credits in two ways. The prior wage standard was 110% of the average weekly wage in the county. The wage standard for Tier 1 counties now equals the lower of three figures: the average private sector weekly wage in the county; the average private sector weekly wage in the State; and the average private sector weekly wage in the county multiplied by the "county income/ratio wage adjustment" factor. The "county income/wage adjustment" determines a single county's ratio per capita income to its annualized private sector wages, and compares this ratio to the same measure for the State as a whole. The act also replaces the prior wage standard for the other tier areas with a standard 10% above the lower of the three figures described above. These changes are effective for the 1997 tax year and later years. The purpose of these changes is to provide an appropriate standard for counties that have unusual situations, such as a single, large employer.

The act allows a taxpayer to specify the tax (income or franchise) against which the credit is claimed when filing a tax return rather than when applying for the credit with the Department of Commerce. This change is effective retroactively to the 1996 tax year and applies to all future years. This change was needed because, when initially applying for the credit, the company may not yet know which tax it will claim the credit against.

The act amends the credit for investing in machinery and equipment by providing that a taxpayer that signs a letter of commitment to place specific machinery and equipment in service in an area within two years after the date the letter is signed, and in fact does so, may calculate the credit based upon the tier the county was in when the taxpayer signed the letter. This same provision is already allowed for purposes of the jobs tax credit. This change, which allows companies to plan major investments without risking a possible tier redesignation for the location of the planned investment, becomes effective for taxable years beginning on or after January 1, 1998.

The act directs the Department of Commerce to study tax incentives for new and expanding businesses enacted in 1996, including their effects on tax equity, their distribution across new and existing businesses, the patterns of business development before and after their enactment, and their costs and benefits, and to study the use of tax incentives by other states.

The Department of Commerce must report the results of its study to the General Assembly by April 1, 1999.

The fiscal impact of the act is estimated to be a loss to General Fund revenues beginning at $ .2 to $ .5 million for fiscal year 1997-98, and growing to a maximum of $14.5 million for fiscal year 2001-02.

S.L. 1997-292 (House Bill 754, Representative Dickson)

AN ACT TO LEVY AN EXCISE TAX ON ILLICIT SPIRITUOUS LIQUOR, AN EXCISE TAX ON MASH, AND AN EXCISE TAX ON ILLICIT MIXED BEVERAGES.

This act expands the excise tax on controlled substances to include a tax on illicit spirituous liquor, mash, and illicit mixed beverages, effective October 1, 1997. Mash is a fermentable starchy mixture from which spirituous liquor can be distilled. Illicit spirituous liquor and illicit mixed beverages are primarily non-tax-paid liquor and mixed beverages that contain non-tax-paid liquor. The new tax is expected to generate between $300,000 and $500,000 annually, of which approximately 75% will be distributed to State and local law enforcement agencies and 25% will be credited to the General Fund.

The tax rate on illicit spirituous liquor is $31.70 for each gallon or fraction thereof sold by the drink and $12.30 for each gallon or fraction thereof not sold by the drink. The tax rate on mash is $1.28 for each gallon or fraction thereof. The tax rate on illicit mixed beverages is $20.00 on each four liters and a proportional sum on lesser quantities. These tax rates are equivalent to the mixed beverage taxes that would be due on the liquor or mixed drinks or on liquor made from the mash. Failure to pay the tax due triggers a penalty equal to 50% of the tax due, the same as the tobacco tax.

The General Assembly enacted the excise tax on controlled substances in 1989 as a means of generating revenue for State and local law enforcement agencies and for the General Fund. Under the law, a person who acquires illegal drugs is required to pay tax on them within 48 hours of acquiring possession if the tax has not already been paid as evidenced by a tax stamp. A person paying the tax is not required to disclose his or her identity and any information obtained in assessing the tax is confidential and cannot be used in a criminal prosecution other than a prosecution for failure to comply with the tax statute itself. Seventy-five percent of the revenue generated by assessments of the tax is distributed to the law enforcement agencies whose investigation led to the assessment. The remainder of the revenue is credited to the General Fund. The excise tax on illicit liquor, mash, and illicit mixed beverages will be administered and distributed in the same manner as the excise tax on controlled substances.

The North Carolina Court of Appeals upheld the constitutionality of the State's excise tax on controlled substances in 1996 and the North Carolina Supreme court affirmed March 7, 1997. The case, State v. Ballenger, was based on the United States Supreme Court's 1995 opinion holding Montana's illegal drug tax unconstitutional because it was a second punishment, not a true tax, and thus violated the double jeopardy clause of the Fifth Amendment. The United States Supreme Court decision was based on two key aspects of Montana's tax: it was at an unusually high rate when applied to certain low-value drugs and it did not apply until a person was arrested for a drug violation. Our Attorney General's office reviewed the Montana case and concluded that our drug tax is not unconstitutional because it applies whether or not a person is arrested for a drug violation. The General Assembly enacted several changes to the law in 1995 to further clarify that the tax is not a punishment, but is in fact a true tax designed to raise revenue.

S.L. 1997-300 (Senate Bill 784, Senator Webster)

AN ACT TO PROVIDE TAX RELIEF AND SIMPLIFICATION BY CONFORMING STATE TAX LAW TO THE FEDERAL RULE THAT GRANTS A FILING EXTENSION EVEN IF THE REQUEST IS NOT ACCOMPANIED BY PAYMENT.

This act conforms the State tax law on filing extensions for certain taxes with federal law by authorizing an extension for filing a return whether or not the tax is paid. The filing extension is not an extension of time for paying the tax, however. The act becomes effective for returns due on or after January 1, 1998.

Under current State law, to obtain an extension of time for filing an income tax return, a corporate franchise tax return, or a gift tax return, the taxpayer must pay the amount expected to be due. If the taxpayer does not pay the tax, the filing extension is not granted and the taxpayer faces penalties for both late filing and late payment. This law was enacted in 1990 to bring State law in conformity with federal law. The federal law has since changed, however. The Internal Revenue Service recently adopted a rule granting a filing extension whether or not the tax is paid. The filing extension is not an extension of time to pay the tax, however. If the tax is not paid by the original due date, a taxpayer who pays when filing the return on the extended date still faces a late payment penalty but not a late filing penalty.

The purpose of granting a filing extension whether or not the tax is paid is to obtain a record of the taxpayer. A taxpayer who could not pay the tax by the due date and thus could not obtain a filing extension under prior law had no incentive to file a request for an extension or to file a return by the extended date. In fact, the accumulated filing penalties could have made the taxpayer less likely to file at all. If a taxpayer does not request an extension or file a return, the Department of Revenue might have no record of the taxpayer and thus might not be able to pursue the unpaid taxes. If the taxpayer requests an extension but does not pay the tax, the Department can contact the taxpayer and try to collect the unpaid taxes, perhaps through an installment agreement.

Conforming the State law to the federal law will simplify tax compliance for taxpayers, who will not have to track separate State and federal rules for obtaining a filing extension. The proposed change will result in some nonrecurring computer programming costs for the Department of Revenue. The Department is authorized to draw these one-time costs from 1997-98 fiscal year income tax collections.

S.L. 1997-307 (Senate Bill 249, Senator Carpenter)

AN ACT TO CLARIFY WHAT FUNDS MAY BE USED TO REPAY SPECIAL OBLIGATION BONDS AND TO MAKE OTHER CHANGES IN THE LAWS CONCERNING THESE BONDS.

This act changes the law on special obligation bonds issued by a unit of local government for a solid waste project, such as a landfill or an incinerator, in the following ways:

1. It allows a local unit that has issued a solid waste special obligation bond to pledge additional nontax revenue in payment of the bond after the bond has been issued.
2. It applies the terms and conditions that apply under G.S. 160A-20 to security interests granted in installment financing agreements to security interests in property to be financed by a local solid waste special obligation bond. Applying these criteria makes it clear that the security interest may extend to land already owned as well as the building to be financed, requires the local government to hold a public

hearing before granting the security interest, and requires approval by the Local Government Commission before granting the security interest.

3. It clarifies that local solid waste special obligation bonds are secured by the nontax funds that are pledged for their payment but can be paid from other funds.

In 1989, the General Assembly authorized local governments to issue special obligation bonds to finance solid waste management projects. A special obligation bond does not require a vote of the people. A solid waste special obligation bond must be secured by a pledge of designated nontax revenues. The nontax revenues can be fees or can be taxes that are levied by another unit of government and shared with the local government that proposes to issue the special obligation bonds. For example, a city can pledge its share of local sales and use taxes because the county levies those taxes. A county can pledge landfill fees or State-shared tax revenue, such as franchise tax revenue.

S.L. 1997-318 (House Bill 96, Representative Dickson)

AN ACT TO DIRECT THE SECRETARY OF REVENUE TO (1) MAKE REFUNDS OF THE INTANGIBLES TAX TO TAXPAYERS WHO PRESERVED THEIR RIGHT TO A REFUND BY PROTESTING PAYMENT WITHIN THE TIME LIMITS SET BY G.S. 105-267 AND (2) NOTIFY AFFECTED INTANGIBLES TAXPAYERS BY MAIL AS SOON AS POSSIBLE OF THE COURT NOTICE IN THE CLASS ACTION LAWSUIT REGARDING REFUNDS.

This act provides a refund of the intangibles tax on stock, with interest, to taxpayers who made a timely protest for the 1990 through 1994 tax years. The State obligated itself to pay protesters their refunds when the General Assembly enacted S.L. 1997-17. In that act, the General Assembly directed the Secretary of Revenue to take no action to collect or assess back intangibles tax for tax years 1990 through 1994 from those taxpayers who did not pay the intangibles tax on North Carolina stock in reliance on the unconstitutional taxable percentage deduction.

In 1996, in Fulton Corp. v. Faulkner[2], the United States Supreme Court held that the taxable percentage deduction in the North Carolina intangible tax on stock violated the commerce clause by discriminating against out-of-state companies. The deduction reduced a taxpayer's liability for the tax in proportion to the amount of business the corporation did in North Carolina. On remand in February 1997, the North Carolina Supreme Court did not order refunds. Instead, it allowed the possibility of curing the past discrimination by the assessment of intangibles tax on those who did not pay in reliance on the unconstitutional taxable percentage deduction. The General Assembly prohibited the assessment of the tax from taxpayers who benefited from the taxable percentage deduction in S.L. 1997-17.

This act does not provide relief to nonprotesters. The Attorney General's office issued an opinion in April 1997 that it would be unconstitutional for the General Assembly to refund intangible taxes not filed under protest. Because the State has no legal obligation to these taxpayers, any payments would be an exclusive emolument prohibited by Article I, Section 32 of the North Carolina Constitution. The exclusive emoluments provision of the State Constitution prohibits the legislature from extending special privileges to a select group of individuals except in consideration of public services.

[2] Fulton Corp. v. Faulkner, 516 U.S. 325, 116 S. Ct. 848, 133 L. Ed. 2d 796 (1996).

Prior to the ratification of this act, the Wake County Superior Court certified Smith v. State as a class action case representing all taxpayers who paid intangibles tax under timely protest. On June 11, 1997, the court entered judgment in favor of the protesters, awarding them full refunds with interest. The attorneys for the protesters requested attorneys fees equal to 16% of the total amount to be paid to protesters. Any such award will be deducted from the interest paid on refunds to the protesters who are members of the class.

In late June and early July of 1997, the court published a notice of the lawsuit and the possibility of opting out in the classified section of the newspapers. The deadline for opting out was July 28, 1997. By opting out, a taxpayer could avoid having attorneys fees deducted from the taxpayer's intangibles tax refund. A taxpayer who opted out will still receive a refund for any of the tax years from 1992 through 1994 for which the taxpayer was a timely protester. Most taxpayers who protested did so only for 1993, 1994, or both. If a taxpayer paid under protest for 1991 but did not "preserve" the protest by filing suit, the taxpayer will not receive a refund for that year unless the taxpayer remained in the class. Most taxpayers did not pay under protest for the 1991 tax year, however.

The Department of Revenue and the State of North Carolina are opposing any award of attorneys fees on the grounds that the Department of Revenue would pay all protesters for the 1992 through 1994 tax years anyway, whether or not there is a court order. To ensure that as many affected taxpayers as possible received actual, complete information before the deadline set by the court for taxpayers to make a decision regarding the class action lawsuit, the General Assembly directed the Secretary of Revenue to mail a copy of the court's notice to as many affected taxpayers as possible.

S.L. 1997-328 (Senate Bill 466, Senator Hartsell)

AN ACT TO EXEMPT FROM STATE INCOME TAX ALL OF THE ANNUAL INVESTMENT INCOME EARNED BY CONTRIBUTORS ON DEPOSITS IN THE PARENTAL SAVINGS TRUST FUND AS WELL AS THE DISTRIBUTIONS TO BENEFICIARIES OF THAT FUND.

This act excludes two types of income from State individual income tax. The items excluded are the annual earnings on amounts contributed to the Parental Savings Trust Fund for the future payment of room or board at an institution of higher education and the earnings distributed to a beneficiary of the Fund that are used to pay for higher education expenses. The act is effective for taxable years beginning on or after January 1, 1998. The revenue loss to the General Fund is expected to be a little over $3,000 in fiscal year 1998-99. The revenue loss will increase to as much as $819,000 by the year 2007.

The Parental Savings Trust Fund is part of the State Education Assistance Authority. The Fund is authorized by G.S. 116-209.25, which was enacted by the 1996 General Assembly. A person can contribute amounts into the Parental Savings Trust Fund for a child who is less than 16 years old. The amount contributed in the account, along with its interest and investment earnings, can be used to pay the expenses of the beneficiary at any accredited public or private college or community college. Either the child or the person making the contributions must be a resident of this State. The Authority plans to begin the Fund in the fall of 1997. The Parental Savings Trust Fund is a kind of qualified state tuition program under section 529 of the Internal Revenue Code.

Section 529 of the Code excludes some of the amounts earned by contributors to a qualified state tuition program from federal tax and, therefore, North Carolina tax as well. Under federal law, earnings on amounts contributed for the payment of tuition, fees, books,

supplies, and equipment at an institution of higher education are excluded from tax but not the earnings on amounts contributed for room and board. Earnings on amounts contributed for room and board are taxable. The taxation of amounts contributed for room and board is consistent with section 117 of the Code concerning the taxation of scholarships. Under that section, an amount received as a scholarship is excluded from taxable income to the extent the amount is for tuition, fees, books, supplies, and equipment required for courses of instruction. The amount of a scholarship that is intended for living expenses (room and board) is subject to tax.

Also under federal law, the amount distributed to a beneficiary of the Parental Savings Trust Fund for tuition, fees, books, supplies, and equipment that exceeds the amount contributed is taxable. Thus, under federal law, the tax on the investment earnings is simply deferred until a distribution is made, at which time the earnings are taxable to the beneficiary rather than the contributor.

The two exclusions allowed by the act will result in a lack of conformity with federal income tax law on these items and with the State and federal law on the subject of income received for the payment of room and board at an educational institution. Because federal taxable income is the starting point for determining State taxable income and the two exclusions in the act differ from federal law, the new exclusions will require new deduction calculations to be made on the State income tax return and necessitate the revision of the form.

S.L. 1997-340 (House Bill 1044, Representative Rogers)

AN ACT TO AUTHORIZE COUNTIES TO DESIGNATE AN OFFICIAL TO RECEIVE SALES TAX REFUND INFORMATION.

The act authorizes a board of county commissioners, in a resolution adopted by the board, to designate a county official to receive certain sales tax refund information from the Secretary of Revenue. Prior law provided for only the chair of the board of county commissioners to receive this information. If the board does not adopt a resolution, then the Secretary will continue to send the requested information to the chair of the board of county commissioners.

In 1995, the General Assembly gave counties access to information regarding local sales tax refunds paid to certain nonprofit entities and governmental entities. Under G.S. 105-164.14, these entities may seek a refund of State and local sales taxes they pay on their purchases by filing a written request for refund with the Department of Revenue and naming the counties where the purchases were made. The Secretary of Revenue then deducts the claimed refunds of local sales taxes from tax revenue distributed to the counties. Prior to 1995, counties did not have access to information regarding local sales tax refunds because the local sales tax is collected by the State and the tax secrecy statute, G.S. 105-259, prevented the Department of Revenue from disclosing information about individual taxpayers. Without this information, counties were not able to audit claims for refunds against them. The counties had to rely on the Department of Revenue to audit the claims, but the Department did not have enough resources to provide the level of audit some counties wished to provide for themselves.

To obtain information concerning local sale tax refunds, a county must request the information in writing from the Secretary of Revenue. The Secretary has 30 days to provide the designated county official with a list of each nonprofit entity or governmental entity that received a refund of at least $1,000 of that county's local taxes within the last 12 months. The county uses the list it receives from the Department of Revenue to identify entities whose refund claims the county may wish to audit. Upon the written request of the county, the entity that has

received a refund must provide the county with a copy of the request for refund, along with supporting documentation requested by the county in order to verify the request. If an entity determines that a refund it has received has been charged to the wrong county, it must file an amended return for the refund. The amended return enables the Department to make the appropriate adjustments in the subsequent quarterly distribution of local sales tax revenue.

The act makes a conforming change to the local sales tax exception to the tax secrecy statute, set out in G.S. 105-259(b)(6a), by providing that a list of claimants that have received a refund may be furnished to a designated county official.

S.L. 1997-355 (House Bill 1158, Representative R. Hunter)

AN ACT TO PROVIDE THAT ANTIQUE AIRPLANES SHALL BE VALUED AT NO MORE THAN FIVE THOUSAND DOLLARS FOR PROPERTY TAX PURPOSES.

This act grants property tax relief to owners of antique airplanes similar to the relief that the 1995 General Assembly gave to owners of antique automobiles. The act provides that antique airplanes that are not used for the production of income will be assessed at the lower of their true value or $5,000, effective for taxable years beginning on or after July 1, 1998. The act is expected to reduce local government property tax revenues by less than $100,000 a year.

An airplane qualifies for this property tax reduction if it meets all of the following conditions:

- It is registered with the Federal Aviation Administration.
- It is a model year 1954 or older.
- It is maintained primarily for use in exhibitions, club activities, air shows, and other public interest functions.
- It is used only occasionally for other purposes.
- It is used by the owner for a purpose other than the production of income.

Non-business property has been exempt from property taxes since 1987. Non-business property means personal property that is used by the owner of the property for a purpose other than the production of income and that is not used in connection with a business. Non-business personal property includes household furnishings, clothing, pets, and lawn equipment. The term includes collectibles such as antique furniture, coins, and paintings. However, the term does not include aircraft. In 1995, the General Assembly granted property tax relief to owners of antique automobiles. Like the non-business personal property tax exemption, the antique automobile tax relief applied only to individuals, not other entities, and applied only if the automobile is not used in connection with a business. This act is not limited to non-business aircraft; it reduces property taxes on antique airplanes even if they are owned by a corporation or other entity and even if they are used in connection with a business.

S.L. 1997-369 (Senate Bill 374, Senator Odom)

AN ACT TO EXEMPT FROM SALES AND USE TAX NUTRITIONAL SUPPLEMENTS SOLD BY CHIROPRACTORS.

This act creates a new State and local sales and use tax exemption. The new exemption is for "nutritional supplements sold by a chiropractic physician at a chiropractic office to a patient as part of the patient's plan of treatment." The exemption became effective October 1, 1997; it will not result in a significant loss of revenue to either the State or the local governments.

The act does not define a nutritional supplement. The federal Dietary Supplement Health and Education Act of 1994 defines a dietary supplement as a product that meets the following three criteria: (i) is intended to supplement the diet and contains a vitamin, mineral, herb, or other botanical, amino acid, or other dietary substance (or a concentrate, metabolite, constituent, extract, or combination of any such ingredient); (ii) is intended for ingestion in tablet, capsule, powder, softgel, gelcap, or liquid form; or if not in such form, is not represented as conventional food or as the sole item of a meal or of the diet; and (iii) is labeled as a dietary supplement.

There are no laws that require any dietary supplements to be sold only by health care providers. The dispensing of dietary supplements does not require a prescription. As a marketing tool, vendors of dietary supplements sell some of their products only to health care providers.

S.L. 1997-370 (House Bill 14, Representative Cansler)

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

This act modifies the sales tax definition of custom computer software to make a clear distinction between software that is subject to State and local sales and use taxes and software that is not subject to these taxes. The act is based on a recommendation of the Revenue Laws Study Committee and reflects an agreement between the Department of Revenue and the North Carolina Electronic & Information Technologies Association on the definition of custom computer software. It becomes effective October 1, 1997, and is expected to cause a General Fund revenue gain of approximately $700,000 a year. Local governments will experience a local sales tax revenue gain of approximately $350,000 a year.

Canned software is subject to sales and use taxes and custom software is not subject to these taxes. The North Carolina sales and use tax law excludes custom computer software from tax to implement the policy that computer services are not subject to sales and use taxes. The cost for custom computer programs is attributable to the programming services provided rather than the cost of producing a tangible form of the program on a cd rom or tape. The definition of custom software in the prior law was very broad, however, and could include off-the-shelf "shrink-wrap" programs and programs that had been modified only slightly by the vendor. Under that definition, custom computer software included all software recommended to the purchaser by the seller after performing an analysis of the purchaser's needs. Thus, under prior law, a common product such as Microsoft's Word program became exempt from sales and use tax if the seller of the program analyzed the customer's needs and decided that Word was better for the customer than WordPerfect or another competing product. This act deletes an analysis of a customer's needs as a determining factor in whether a program is custom (exempt) or canned (taxable).

The definition of custom software in the prior law also included all programs adapted by the seller of the program to be used in a particular computer and its associated input/output

devices such as printers. This type of adaptation can be slight, such as the completion of a "fill-in-the-blank" series in which the particular hardware to be used with the program is designated, or it can include extensive changes to the lines of source code in the software. Under the prior law definition, any slight adaptation of a program made the entire program exempt from State and local sales and use taxes. This act changes the law by providing that custom software does not include prewritten software that can be installed and executed with no changes to the software's source code other than changes made to configure hardware or software.

S.L. 1997-380 (Senate Bill 389, Senator Hoyle)

AN ACT TO ESTABLISH THE FORSYTH-GUILFORD METROPOLITAN BASEBALL PARK DISTRICT, TO PROVIDE FOR A REFERENDUM ON BASEBALL PARK FINANCING IN THE DISTRICT, AND TO ALLOW BASEBALL PARK DISTRICTS TO ENTER INTO INSTALLMENT FINANCING AGREEMENTS.

This act establishes the Forsyth-Guilford Metropolitan Baseball Park District and its governing body, the Park Authority. The bill authorizes the Authority to:

- Construct, finance, and operate a major league baseball park.
- Levy a 1% prepared meals tax and a 50¢ baseball park ticket tax.
- Finance the baseball park by using certificates of participation.

The District will be a unit of local government and will consist of Forsyth and Guilford Counties. The proposed 1% District meals tax and 50¢ baseball park ticket tax will be put to a vote in both counties on May 5, 1998. If the majority of voters in either of these counties does not vote in favor of the proposed taxes, the District is dissolved and the tax cannot be levied in either county.

The Authority will have 13 members, appointed as follows:

- One by the Governor
- Two the General Assembly upon the recommendation of the President Pro Tempore of the Senate
- Two by the General Assembly upon the recommendation of the Speaker of the House of Representatives
- Four by the Guilford County Board of Commissioners
- Four by the Forsyth County Board of Commissioners

All appointees must be residents of the District at the time of their appointment and the appointees of Guilford and Forsyth County must be residents of the appointing county.

When constructing and operating a baseball park, the Authority is exempt from most of the purchase and contract procedures that apply to local units of government. It also has the power of eminent domain, which can be used to acquire land for the baseball park or for highway improvements that will benefit the baseball park. However, the power of eminent domain may not be used until after Major League Baseball has announced approval of the award of a franchise for a location within the District. Also, the board of commissioners of the

county in which the property to be condemned is located must have approved of the condemnation by adoption of a resolution.

The Authority can levy a 1% prepared meals tax in the District and a 50¢ baseball park ticket tax if Major League Baseball has announced the approval of an award of a franchise in a location in the District by December 31, 2001, and the voters in the District approve the levy. The tax proceeds can be used for any activity of the District. Any tax proceeds used to design, construct, equip, or improve the baseball park must be matched by private funds. Every $2.00 of tax proceeds must be matched by $1.00 in private funds.

The Authority may not levy the prepared meals tax unless it also levies the ticket tax. If the Authority repeals the ticket tax, the prepared meals tax is automatically repealed on the same date. The prepared meals tax can be used to finance a principal amount of no more than $140 million for constructing the baseball park, plus interest, issuance costs, and related debt service. The prepared meals tax sunsets once this amount has been raised, as determined by the Authority Finance Officer. The prepared meals tax also sunsets after all debt incurred to design, construct, equip, or improve the baseball park has been retired, as determined by the Authority Finance Officer.

Any lease of the baseball park must be a triple net lease for a minimum of 25 years. The Authority has zoning power over land owned by the District, and land owned by the District is not subject to involuntary annexation.

S.L. 1997-388 (House Bill 611, Representative Hackney)

AN ACT TO INCREASE THE COMPENSATION PROVIDED TO PERSONS ERRONEOUSLY CONVICTED OF FELONIES WHO HAVE RECEIVED PARDONS OF INNOCENCE, TO EXEMPT THE COMPENSATION FROM STATE INCOME TAX, AND TO PROVIDE FOR THE INDUSTRIAL COMMISSION TO HANDLE THE CLAIMS OF THOSE PERSONS.

This act makes several changes to the law that allows the State to compensate people who have been erroneously convicted and imprisoned of a felony:

- It increases the amount a person may be awarded.
- It changes the agency that determines the award from the Department of Correction to the Industrial Commission.
- It provides that the petition must be presented to the Industrial Commission within five years after the pardon was granted.
- It repeals the requirement that the claimant must have sustained pecuniary loss through the erroneous conviction and imprisonment.
- It allows the Industrial Commission to make the award, rather than the Governor upon the approval of the Council of State.
- It clarifies that the amount awarded to the claimant is exempt from State income tax.

Under prior law, a person who had been granted a pardon of innocence for the erroneous conviction and imprisonment of a felony could petition the State for compensation for the financial loss sustained by the person through the erroneous conviction and imprisonment. The petition was presented to the Department of Correction and the Parole Commission would

conduct a hearing. To support an award, the Parole Commission had to find that the person was erroneously convicted and imprisoned and that the person sustained a financial loss as a result. The Parole Commission would then report its conclusions and recommendations to the Governor. The Governor, upon the approval of the Council of State, was authorized to award the claimant the amount recommended by the Parole Commission. The Governor could not make an award that exceeded $500 for each year imprisoned or a total of $5,000.

Under this act, a person would have five years from the granting of the pardon to present a petition to the Industrial Commission for compensation from the State for the financial loss the person suffered because of an erroneous conviction and imprisonment. Upon finding that the person was granted a pardon of innocence, the Commission must determine the amount the claimant is entitled to be paid and must enter an award for that amount. A claimant will be entitled to an amount equal to $10,000 for each year or the pro rata amount for the portion of each year of the imprisonment. The compensation may not exceed a total of $150,000. The Commission must give written notice of its decision to all parties concerned. Its determination is subject to judicial review.

Section 4 of the act clarifies that the amount awarded to a claimant is not subject to State income tax. Under existing law, it is unclear whether the amount awarded to a claimant is exempt from federal income tax. Prior to 1996, section 104 of the Internal Revenue Code exempted amounts received as damages on account of personal injuries and sickness. In 1996, Congress amended this section to say that gross income does not include "the amount of damages received on account of personal physical injuries or physical sickness." Because of the 1996 federal tax law change, it is questionable whether the compensation would be exempt under federal law. To the extent the income is subject to federal income tax, it would automatically be subject to State income tax. Section 4 provides that to the extent the compensation is included in federal taxable income, it may be deducted for State income tax purposes.

The act is effective when it becomes law and applies to persons pardoned on or after July 1, 1995. The income tax clarification becomes effective for taxable years beginning on or after January 1, 1997.

S.L. 1997-392 (House Bill 225, Representative Weatherly)

AN ACT TO PROVIDE FOR CLEANUP OF DRY-CLEANING SOLVENT CONTAMINATION IN NORTH CAROLINA, AS RECOMMENDED BY THE ENVIRONMENTAL REVIEW COMMISSION.

This act requires owners and operators of dry-cleaning facilities to maintain financial responsibility for liability arising from dry-cleaning solvent pollution and creates a Dry-Cleaning Solvent Cleanup Fund to be used to reimburse persons who clean up sites polluted by dry-cleaning solvents that have contaminated the water or surface or subsurface soils of the State. The Fund will be administered by the Department of Environment and Natural Resources. No more than 20% of the amount of revenue in the Fund may be used by the Department for the costs of administering the Fund. The act is a recommendation of the Environmental Review Commission.

The major source of revenue for the Fund is the imposition of a dry-cleaning solvent tax on in-State retailers that sell solvent to dry-cleaning facilities and on dry-cleaning facilities that purchase solvent outside the State. The solvent tax is a per gallon privilege tax equal to $5.85 per gallon of chlorine-based solvents and 80¢ per gallon of hydrocarbon-based solvents. The tax is effective October 1, 1997, and expires January 1, 2010. The Department of Revenue

will collect the tax in the same manner as a sales tax. The Secretary of Revenue may retain the Department's cost of collection, not to exceed $125,000 a year. After subtracting these costs and the Department of Environment and Natural Resources administration costs, the tax is expected to generate about $1 million a year for the Dry-Cleaning Solvent Cleanup Fund.

If the amount of claims exceeds the amount of revenue in the Fund, the claims with the highest priority will be paid first. The Department of Environment and Natural Resources must adopt rules to implement the act, including rules for the prioritization of sites and scheduling of funding for assessment and remedial response activities. A petitioner for money from the Fund must meet certain requirements and make a financial contribution. The amount a petitioner may receive from the Fund is capped at $200,000 a year unless the contamination poses an immediate threat to human health or a serious risk of irreparable damage to the environment, in which case a cap of $400,000 applies.

S.L. 1997-397 (Senate Bill 847, Senator Odom)

AN ACT TO EXEMPT FROM SALES AND USE TAX REUSABLE INDUSTRIAL CONTAINERS USED AS PACKAGING FOR TANGIBLE PERSONAL PROPERTY.

This act provides a sales and use tax exemption for containers that are used as packaging to enclose property delivered to a purchaser and must then be returned to the owner. Under prior law, packaging items were exempt from sales tax only if they constituted part of the property being sold and were delivered with the property to the customer. The act becomes effective October 1, 1997. It is not known how much the act will reduce General Fund revenues and local government sales tax revenues.

The act applies to barrels used to transport chemicals and tanks used to transport gases, such as oxygen, acetylene, and propane. In a typical situation, barrels are leased by the barrel company to the chemical company, which fills them with chemicals that are then sold to the customer. The customer returns the barrel, which can then be reused. Under prior law, the chemical company (lessee) was required to pay sales tax to the barrel company (lessor) on the lease price of the barrel. If the barrels had been purchased by the chemical company and sold to the customer, however, they would have been tax exempt. The prior law was, therefore, a disincentive for recycling. The customer would likely discard a purchased barrel and buy a new one when buying more chemicals.

The act does not apply to railroad tank cars or to truck trailers because motor vehicles are not packaging. The act does not apply to railroad palettes because they do not enclose the property being delivered.

S.L. 1997-417 (House Bill 1231, Representative Miner)

AN ACT TO AUTHORIZE SUPPLEMENTAL SOURCES OF REVENUE FOR LOCAL GOVERNMENT TRANSIT FINANCING.

This act has four parts that provide local governments with revenue options to finance local public transportation systems, as follows:

I. It authorizes Mecklenburg County to levy a ½ cent local sales tax if approved by the voters of the county.

II. It authorizes most cities that have public transportation systems to levy an additional $5 motor vehicle tax.

III. It authorizes regional public transportation authorities to levy a gross receipts tax of up to 5% on short-term motor vehicle rentals.

IV. It authorizes the new Triad regional transportation authority to levy the same $5 vehicle registration tax that the existing Triangle regional public transportation authority levies. It also authorizes public transportation authorities organized under existing law and comprised of two or more counties to levy this same $5 vehicle registration tax.

Part I of the act authorizes Mecklenburg County to levy a ½ cent sales tax only if the tax is approved by the voters of the county. The tax does not apply to food. In other respects, it will be administered in the same way as the existing local sales and use taxes.

The proceeds of the tax must be used to finance, construct, operate, and maintain local public transportation systems. A public transportation system is defined broadly in the act to include any combination of real and personal property established for purposes of public transportation. It does not include, however, streets, roads, and highways not dedicated to public transportation or related parking.

Mecklenburg County may not levy the sales tax authorized by Part I of this act unless it has developed a financial plan for equitable allocation of the proceeds it receives based on the identified needs of local public transportation systems in the county and planned expansion of public transportation to unserved areas. The sales tax authorized for Mecklenburg County will be distributed between the county and other local government units in the county that operate local public transportation systems, on a per capita basis. The county must allocate the tax proceeds it receives based on its financial plan.

Part II of the act authorizes most municipalities that operate public transportation systems to levy an additional $5 motor vehicle tax, to be used only to finance, construct, operate, and maintain local public transportation systems. Current law already authorizes municipalities to levy a $5 annual motor vehicle tax that may be used for any public purpose. Many municipalities already have local legislation authorizing them to levy an increased amount. This act adds an extra authorization for $5 more. If that $5 would cause the municipality's total local motor vehicle tax to exceed $30, however, the additional $5 tax may not be levied. The City of Charlotte and the Town of Matthews are authorized by local act to levy annual motor vehicle taxes of $30. These local units are the only ones that would currently be affected by the $30 limitation. The City of Durham and the cities and towns in Gaston County are specifically prohibited from levying this additional $5 for local transportation authorities.

Part III of the act authorizes a regional public transportation authority to levy a gross receipts tax of up to 5% on retailers within the region engaged in the business of renting private passenger motor vehicles and motorcycles. The tax applies only to short-term rentals, i.e., rentals for a period of less than one year. The tax will be collected by the authority but is otherwise administered in the same way as the optional highway use tax on gross receipts from vehicle rentals. This optional highway use tax is 8% on short-term rentals, so the combined tax within the jurisdiction of the authority would be 13%. Each authority may use the proceeds of the tax for its public transportation purposes. Before levying or increasing the tax, the authority must obtain approval from each county in the region.

A regional transportation authority is an entity created under either Article 26 or Article 27 of Chapter 160A of the General Statutes to provide a public transportation system for the region it represents. The authority created under Article 26, the Triangle Transit Authority for Wake, Durham, and Orange Counties, is governed by a board of trustees appointed by the counties creating the authority and larger cities within the counties. The 1997 General Assembly authorized the creation of a second regional transportation authority for the Triad region, in S.L. 1997-393. The Triad Transit Authority may be created by the four largest cities of the five counties served by the Authority in order to promote the development of sound transportation systems in the area served by the Authority. The Authority would be governed by a board of trustees consisting of the mayors of the four largest cities and the chair of each Metropolitan Planning Organization in the area. The counties served by the Authority would be Forsyth, Guilford, Randolph, Davidson, and Alamance. The four major cities involved in the creation of the Authority are Greensboro, High Point, Winston-Salem, and Burlington.

Part IV of the act authorize the proposed Triad regional transportation authority and any multi-county public transportation authorities organized under current law to levy a $5 vehicle registration tax identical to the tax already authorized for, and levied by, the existing Triangle Transit Authority. A public transportation authority is an entity created by one or more local government entities under Article 25 of Chapter 160A of the General Statutes to provide public transportation. There are three multi-county public transportation authorities. The Choanoke Public Transportation Authority consists of Bertie, Halifax, Hertford, and Northampton Counties. The Kerr Area Transportation Authority consists of Franklin, Granville, Person, Vance, and Warren Counties. The Inter-County Public Transportation Authority consists of Camden, Chowan, Currituck, Pasquotank, and Perquimans Counties.

An authority must obtain the approval of each county within its jurisdiction before it can levy the $5 vehicle registration tax. The Division of Motor Vehicles will collect the tax in counties that are entirely located within the authority's jurisdiction. If the authority's jurisdiction includes just a part of one or more counties, the authority will collect the registration tax in those parts of counties. The authority may contract with local governments to collect this tax. Authorization for authorities to levy this tax is organized into a new Article in Chapter 105 of the General Statutes; accordingly, the Triangle Transit Authority's tax is recodified from Chapter 160A to the new Article in Chapter 105.

S.L. 1997-423 (House Bill 35, Representative Capps)

AN ACT TO EXTEND THE TIME ALLOWED FOR CLAIMING SALES TAX REFUNDS, MOTOR FUEL TAX REFUNDS, AND ALTERNATIVE FUEL TAX REFUNDS, AND TO PROVIDE THAT A MOTOR FUEL TAX REFUND IS NET OF THE SALES TAX DUE ON THE FUEL.

This act extends the time for claiming sales tax refunds for certain nonprofit entities, certain governmental entities, and drugs purchased by hospitals. A late application for a sales tax refund may now be filed with the Department of Revenue after 30 days but within three years after the due date, subject to a 50% penalty. The penalty for a late filing within 30 days after the due date is 25%. The Secretary of Revenue has the authority to waive penalties for good cause, but once a refund is barred the Secretary may not revive it. Prior law required that the application for a refund filed after 30 days be filed within six months after the due date in order to receive a refund subject to the 50% penalty. The due date for nonprofit entities and certain hospitals is October 15 following the first six months of a calendar year and April 15 following the second six months. The due date for governmental entities is six months after

the end of each fiscal year. The Department of Revenue had suggested to the Revenue Laws Study Committee that the statute of limitations for late filings of applications for sales tax refunds for these nonprofit entities, governmental entities, and hospitals be extended from six months to three years in order to bring them in line with the due date for applications for tax refunds for all other taxes, except those on property, as set out in G.S. 105-266 and G.S. 105-266.1. In past years, bills have been introduced for refunds for nonprofit entities and State agencies whose refunds have been barred because their applications were filed six months after the due date. The Department of Revenue informed the Revenue Laws Study Committee that by increasing the filing deadline to three years, most of the refund legislation could be eliminated. The extension of sales tax refunds for these nonprofit entities, governmental entities and hospitals is effective January 1, 1998. However, notwithstanding the three-year extension, the act provides that an application for a refund of sales taxes paid by a nonprofit entity or hospital is timely filed if it is filed within four years after the due date and before July 1, 1998. This one-time provision is effective immediately, but the Department of Revenue will not issue a sales tax refund for these nonprofit entities or hospitals until July 1, 1998.

The act also extends the time for filing an application for a refund on motor fuel taxes and alternative fuel taxes from six months to three years. The act further amends the tax laws affecting motor fuel and alternative fuel by assessing sales and use tax on (1) motor fuel for which a refund of the motor fuel tax is allowed because the motor fuel is accidentally mixed with some other type of fuel or the motor fuel is used in a boat, and (2) alternative fuel and motor fuel for which a refund of the fuel tax is allowed for fuel used for other than to operate a licensed highway vehicle or for fuel used in certain vehicles with power attachments. Prior law exempted motor fuel and alternative fuel from sales tax, regardless of whether the fuel was taxed or a refund of the tax paid was allowed.

The act provides that any sales and use tax due on motor fuel used other than to operate a licensed highway vehicle or used in certain vehicles with power attachments, is to be subtracted from any refund a taxpayer receives on motor fuel tax paid on that fuel. Prior law allowed a refund on motor fuel tax paid on fuel used for off-highway purposes or in certain vehicles with power attachments and no sales tax was deducted or payable. This refund was for the flat cents per gallon rate less one cent. The one cent was retained to liquidate highway bonds. The act sets out a formula for determining the sales and use tax to be deducted from the motor fuel tax refund. This formula provides that the price of motor fuel subject to sales tax is the average of the wholesale prices used to determine the fuel tax rates in effect for the two six-month periods of the year for which the refund is claimed. The one cent holdback is eliminated by the act, because the highway bonds have been paid off. The changes to the tax laws effecting motor fuel and alternative fuel taxes become effective January 1, 1998, and apply to taxes paid on or after that date.

The maximum loss to the General Fund from extending the refund period from six months to three years is not expected to exceed $200,000 annually. The gain in General Fund revenues from changes made to the sales tax on motor fuels is estimated to be $797,525 annually. The net revenue loss to the Highway Fund from the elimination of the one-cent holdback is $200,000 annually.

S.L. 1997-439 (House Bill 1157, Rep. Morris)

AN ACT TO CLARIFY THE CORPORATE INCOME TAX ON CERTAIN TAX-EXEMPT OBLIGATIONS, TO DELETE THE CAP ON CORPORATE INCOME TAX DEDUCTIONS OF

DIVIDENDS RECEIVED FROM REGULATED INVESTMENT COMPANIES, AND TO ALLOW THE DEPARTMENT OF REVENUE TO DEDUCT ITS COST OF ADMINISTERING THE DISTRIBUTION OF GROSS RECEIPTS TO CITIES.

This act makes the following three changes. The first two changes were recommended by the North Carolina Bar Association.

1. It adds to the corporate income tax statutes the tax exemption already provided in the bond statutes for interest on State or local obligations and obligations of nonprofit educational institutions organized or chartered in the State. to corporations, effective beginning with the 1997 tax year.
2. It conforms statutory law to the current practice of the Department of Revenue with regard to the taxability of dividend income received by corporations from regulated investment companies and real estate investment trusts, effective beginning with the 1997 tax year.
3. It provides that the State will deduct from its distributions to cities of shared franchise gross receipts taxes the State's cost of administering the sharing, effective August 28, 1997.

The bond laws exempts interest on State and local government obligations and on obligations of nonprofit educational institutions organized or chartered in the State from State income tax. The existing individual income tax statutes provide for this deduction but it was not mentioned in the corporate income tax statutes. Section 1 of the act made a conforming change in the corporate income tax statutes to specifically exempt interest on State and local government obligations and on obligations of nonprofit educational institutions organized or chartered in the State from State income tax.

Section 2 of the bill conforms the language of the corporate dividend statute to the existing practice of the Department of Revenue with regard to the taxability of income received by a corporation from regulated investment companies and real estate investment trusts. Corporations and individuals may invest income in a regulated investment company, commonly known as a mutual fund, and in a real estate investment trust. Under the Code, dividends paid by a regulated investment company or a real estate investment trust to its shareholders are treated as pass-through income, meaning that the character of the income remains the same after that income is passed to its shareholders. For example, interest on a State municipal bond is exempt if paid directly to a person. Under the Code, this income does not lose its tax-exempt status if the person receives it as a dividend from a regulated investment company or a real estate investment trust rather than directly from the tax-exempt source.

State corporate income tax law likewise provides that a corporation may deduct from State taxable income that portion of the dividends it receives from a regulated investment company or a real estate investment trust that it could deduct if it received the dividends directly, rather than through the regulated investment company or the real estate investment trust. The statute, however, appears to limit the amount a corporate investor may deduct under this pass-through treatment to $15,000. The Department of Revenue does not currently treat the cap as applicable to these types of pass-through income from federal, State, and local obligations. Arguably, this practice conflicts with the $15,000 statutory limitation. This section repeals the $15,000 cap.

The State shares part of the State gross receipts franchise taxes imposed on utilities to the cities. The franchise taxes that are distributed are the taxes on electricity, piped natural

gas, and telephone service. The formula for these distributions were modified in S.L. 1997-118. Section 3 of this act provides that the State's costs of administering the distributions are deducted from the amounts distributed, so that cities rather than the State bear the cost of sharing part of the State's tax revenues with the cities.

S.L. 1997-443 (Senate Bill 352, Senator Plyler)

AN ACT TO MAKE BASE BUDGET APPROPRIATIONS FOR CURRENT OPERATIONS OF STATE DEPARTMENTS, INSTITUTIONS, AND AGENCIES, AND FOR OTHER PURPOSES.

The Current Operations and Capital Improvements Appropriations Act of 1997 contains one tax law change. The act extends the sunset of the State ports income tax credit from February 28, 1998, to February 28, 2001, and increases the maximum cumulative credit from $1 million to $2 million per taxpayer. This increase is effective for taxable years beginning on or after January 1, 1998. The act is expected to reduce General Fund revenues by $500,000 in 1998-99. The amount of the tax credit allowed is equal to the amount of charges paid to the North Carolina Ports Authority in the taxable year that exceeds the average amount of charges paid to the Authority for the past three years. The credit is limited to 50% of the tax imposed on the taxpayer for the taxable year. Any excess credit may be carried forward and applied to the taxpayer's income tax liability for the next five years.

The 1992 General Assembly enacted the State ports income tax credit to encourage exporters to use the two State-owned port terminals at Wilmington and Morehead City. When enacted, the credit applied to amounts paid by a taxpayer on any cargo exported at either port. In 1994, the General Assembly expanded the credit to include all amounts assessed on exported cargo, regardless of who paid the shipping costs. In 1995, the General Assembly expanded the credit to include some imports by allowing a credit for break-bulk cargo and container cargo imported at either Wilmington or Morehead City and for bulk cargo imported at Morehead City. It did not allow a credit for bulk cargo imported at Wilmington. The credit for bulk exports was also limited to bulk exports at only the Morehead City terminal. The 1996 General Assembly expanded the State ports income tax credit to include the importing and exporting at either terminal of one specific type of bulk cargo: forest products. All imports and exports of bulk cargo at the Morehead terminal were already covered, so the effect of this change was to allow a credit for forest product imports and exports at both terminals.

Bulk cargo is a type of commodity that is loose and usually stock-piled. Examples of this type of commodity include coal, grain, salt, and wood chips. Break-bulk cargo and container cargo are different methods used to ship the same type of commodity. Commodities that are packaged in a metal trailer box that can be locked onto a tractor-trailer chassis and then detached and put on a ship without any other handling are considered "container cargo". Commodities that are packaged and stored on pallets or in cases that must be handled and stacked onto a ship by hand, crane, etc., are considered break-bulk cargo. Break-bulk cargo also includes machinery.

S.L. 1997-463 (Senate Bill 730, Senator Ballance)

AN ACT TO AMEND THE LAW RELATING TO THE ISSUANCE OF BONDS BY INDUSTRIAL FACILITIES AND POLLUTION CONTROL FINANCING AUTHORITIES.

This act makes the following changes to the law authorizing county authorities to issue industrial revenue bonds to finance qualifying industrial or pollution control projects for private

manufacturing firms:

1. It increases the maximum term of the bonds from 30 to 35 years, and provides that refunding bonds may have the same maximum term. (Sections 1 and 4)
2. It requires a county to hold a public hearing before asking the Secretary of Commerce to approve the issuance of bonds for a proposed project. Under current law, the Secretary of Commerce has discretion to request the county authority to hold a public hearing; by rule, the Secretary requires a public hearing to be held in every case. (Section 2)
3. It imposes a seven-day turn-around time on DEHNR's required certification that a proposed industrial project will not have an adverse effect on the environment or that a proposed pollution control project will have a favorable impact on the environment or will prevent or diminish pollution. This certification is necessary before the Secretary of Commerce can approve bonds for a proposed project. (Section 2)
4. It provides that the Secretary of Commerce's certificate of approval, which is valid for one year, will remain valid for three years after bonds are first issued if bonds are issued during the initial one-year period of validity. This change will allow a company to get certification of a large project and then issue bonds over a three-year period. (Section 2)
5. It provides that if a proposed project is located in two or more counties, the county authority of any of those counties may issue the bonds if each affected county and county authority has consented. (Section 3)

Industrial Revenue Bonds offer companies engaged in manufacturing long-term debt financing at interest rates substantially below the current prime rate. There are three types of bonds: tax-exempt bonds for industrial projects, tax-exempt bonds for pollution control projects, and federally taxable bonds for industrial projects. Under the program, a county authority may enter into a financing agreement with a company to provide revenue bond proceeds to the company to be used to finance capital expenditures, such as fixed assets, land, buildings, and equipment. The amounts payable by the company to the authority under the financing agreement must be sufficient to pay all of the principal and interest on the bonds.

Before bonds can be issued, the proposed project must be approved by the Secretary of Commerce and the bonds must be approved by the Local Government Commission. Bond proceeds cannot be used to refinance existing debt or as venture capital. Nor can they be used for a project that will result in the closing of another facility in North Carolina. The proposed project must generate a number of jobs that is commensurate with the cost of the project and will have a measurable impact on the local economy.

Typical industrial projects are new or expanded product manufacturing facilities, distribution centers, and research and development facilities necessary to the manufacturing process. To qualify for bonds for an industrial project, the company must agree to pay its employees at least the average weekly manufacturing wage of the county or the State average weekly manufacturing wage plus 10%. This wage requirement may be waived if the project is to be located in an area of especially severe unemployment.

After a project has been approved by the Department of Commerce, there is no mechanism to follow up to make sure the standards for job creation and wage level are actually met. The Department of Commerce has not been provided the resources that would be necessary for this type of oversight and auditing.

The federal government designates the maximum amount of tax-exempt industrial revenue bonds each state may issue, based on population. The 1997 amount for North Carolina is $377 million. For a single project, tax-exempt bonds may be used to finance capital expenditures of no more than $10 million over a six-year period. In addition, a company may not have more than $40 million in tax-exempt bonds outstanding nationwide at any given time.

The following chart shows the history of Industrial Revenue Bonds, both taxable and tax-exempt:

Year	Projects	($Mil)
1987	11	44.05
1988	19	70.00
1989	45	265.25
1990	20	103.30
1991	18	223.40
1992	11	53.10
1993	7	88.00
1994	10	46.40
1995	29	380.60
1996 to date	26	153.20
1997	18	$110.73

S.L. 1997-475 (Senate Bill 727, Senator Miller)

AN ACT TO REDUCE THE STATE SALES TAX ON FOOD BY AN ADDITIONAL ONE CENT EFFECTIVE JULY 1, 1998, TO ESTABLISH THE PERCENTAGE RATES FOR THE INSURANCE REGULATORY CHARGE AND THE PUBLIC UTILITY REGULATORY FEE, TO CLARIFY THE BASIS OF THE PREMIUM TAX LIABILITY ON WHICH THE INSURANCE REGULATORY CHARGE IS LEVIED, TO INCREASE COURT FEES IN CRIMINAL CASES, TO INCREASE THE FEES FOR FILING CERTAIN DOCUMENTS, AND TO PROVIDE THAT ANNUAL REPORTS OF MOST BUSINESS CORPORATIONS SHALL BE FILED WITH THE DEPARTMENT OF REVENUE RATHER THAN THE SECRETARY OF STATE.

This act reduces the State sales tax on food, sets the insurance regulatory charge and the public utility regulatory fee, clarifies the basis for calculating the insurance regulatory charge, provides that most corporate annual reports will be filed with the Department of Revenue rather than the Secretary of State, and makes other changes not related to the tax law.

Part I of the act reduces the State sales tax on food from 3% to 2%, effective July 1, 1998, and is expected to reduce General Fund revenues by about $90 million a year. In 1996, the General Assembly reduced the State sales tax on food from 4% to 3%, effective January 1, 1997. This act does not repeal or reduce the local 2% sales tax on food. The reduced State sales tax rate applies to food that may be purchased with food stamps. Federal law determines what can be purchased with food stamps and, therefore, what food is subject to the reduced State sales tax.

Examples of food items that are subject to the reduced State sales tax rate are fruits, vegetables, bread, meat, fish, milk, snack foods such as candy, gum, soft drinks, and chips,

distilled water, ice, tomato plants, fruit trees, and cold prepared food for home consumption. Items that are not considered food items under federal law and therefore remain subject to the 4% State sales tax include alcoholic beverages, tobacco products, pet food, prepared foods that are hot at the point of sale and are therefore ready for immediate consumption, such as a broiled chicken kept in a heated display case, and food, such as a hamburger, a pastry, or soup, that is marketed to be heated on the premises of the retailer in a microwave oven or other heating device.

Part II of the act increases the insurance regulatory charge from 7.25% to 8.75% for the 1997 tax year and is expected to generate an additional $3 million in revenue. The insurance regulatory charge was first imposed in 1991 in order to make the Department of Insurance receipt-supported and thereby eliminate General Fund support of the Department. The regulatory charge is imposed on insurance companies that pay the gross premiums tax, other than service corporations such as Blue Cross/Blue Shield and Delta Dental Corporation. Health maintenance organizations do not pay the regulatory charge because they do not pay the gross premiums tax. The charge is a percentage of the insurance company's premiums tax liability.

In 1995, the General Assembly eliminated the insurance audit and examination fees for insurance companies, HMOs, medical corporations, and guaranty associations. The revenue generated by these audit fees was an estimated $4.5 million annually. Consequently, the costs of the audits is now paid for by the insurance regulatory charge as part of the costs of regulating the insurance industry. The increase in the regulatory charge proposed by this act will not fully compensate the General Fund for the 1995 change in the audit fee provisions. The regulatory charge will need to be increased another 0.35% to 9.10% in 1998-99 to fully fund the action taken by the General Assembly in 1995.

Part II of this act also clarifies that the premiums tax liability upon which the charge is levied is not reduced by any tax credits allowed a taxpayer for guaranty or solvency fund assessments. It also makes two technical changes. It deletes the reference to insurance companies regulated under Article 66 of Chapter 58 because no insurance company is regulated under that Article. That Article is the Hospital, Medical and Dental Service Corporation Readable Insurance Certificates Act. It also deletes references to tax paid under G.S. 97-100. Self-insurers pay premiums tax under Article 8B of Chapter 105 of the General Statutes.

Part III of this act decreases the public utility regulatory fee levied in G.S. 62-302 from 0.10% to 0.09% for the 1997 tax year and is expected to reduce the fee revenue by $870,000. The utility regulatory fee was imposed in 1989 in order to defray the State's cost in regulating public utilities. This act reduces the fee because the lower rate, combined with other available revenues, will generate sufficient funds for the estimated costs of operating the North Carolina Utilities Commission and the Public Staff. The regulatory fee is imposed on all utilities that are subject to regulation by the Utilities Commission. The fee is a percentage of the utility's North Carolina jurisdictional revenue. In general, jurisdictional revenue is revenue derived from providing utility service in North Carolina.

Parts IV and V of this act make changes that are not related to the tax law. Part VI of this act provides that most business corporations will file their corporate annual report with the Department of Revenue at the same time that they file their corporate income and franchise tax returns, and raises the annual report filing fee from $10.00 to $20.00. Increasing the fee will generate an additional $1.25 million in revenue each year and transferring the corporate report filing to the Department of Revenue will increase the Department's operating costs by about $112,000 a year. Under prior law, the corporate annual reports were filed with the

Secretary of State on the anniversary of the business' incorporation. This Part becomes effective January 1, 1998, but reports filed with either the Department of Revenue or the Secretary of State during the 1998 calendar year will be considered filed with the correct agency.

This Part of the act is one of the recommendations of the General Statutes Commission. The change is designed to make filing annual reports easier for corporations, to set the due date for the annual report at the due date for filing tax returns (which is a more familiar deadline than the current due date), to allow corporations the benefit of making a single filing with one agency rather than multiple filings with different agencies, and to reduce inadvertent failures to file the annual report. Any amendments to annual reports will continue to be filed with the Secretary of State.

Insurance companies will continue to file their annual reports with the Secretary of State, but on a day set with reference to tax filing dates rather than on the anniversary of their incorporation. The Secretary of State and the Secretary of Revenue are required to prescribe a form jointly for annual reports. The contents of the annual report are being changed to delete the requirement that the names of directors be included in the report because this information is considered not useful to the public. This Part also authorizes a corporation to certify that there are no changes from the previous annual report in order to eliminate the burden of filling out repetitious reports.

S.L. 1997-490 (Senate Bill 39, Senator Larry Shaw)

AN ACT TO REVISE THE SETOFF DEBT COLLECTION ACT.

This act modifies the Setoff Debt Collection Act, Chapter 105A of the General Statutes. Under that Act, the Department of Revenue sends the income tax refund of an individual who owes money to a State agency to that agency in payment of the debt rather than to the individual. The debt the individual owes the agency is set off against the individual's income tax refund.

The Revenue Laws Study Committee recommended this act to the 1997 General Assembly. The modifications made to the Setoff Debt Collection Act apply to tax refunds determined on or after January 1, 2000. The act expands and streamlines the setoff program as follows:

1. It requires all State agencies not given a waiver by the State Controller to use the setoff program to collect debts owed the agency. Under existing law, the State agencies that are included in a list in the statute must use the setoff program to collect debts and those that are not listed cannot use the setoff program.
2. It extends the setoff program to local units of government and their agencies and establishes the procedures local units and their agencies must follow to use the setoff program. The act allows, but does not require, local entities to use the setoff program.
3. It streamlines the setoff program by eliminating several unnecessary notices between the Department of Revenue and the claimant agencies. It accomplishes this by allowing the Department to place refunds of debtors of State agencies in escrow while the State agency finalizes the setoff.
4. It shifts the cost of the program from the agencies whose debts are collected to the debtors who owe the debts, sets a $15.00 cap on the fee imposed for collection

through setoff, and shifts the cost of collecting child support debts from all the State agencies that use the setoff program to an earmarking of income tax collections.

5. It clarifies and reorganizes some of the provisions in the Setoff Debt Collection Act.

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

Expansion to Local Governments: The idea to expand the setoff program to local entities originated with Senate Bill 761 of the 1995 Session, introduced by Senator Conder. The act authorizes local governments to submit their debts for collection by setoff only after providing the debtor with notice, an opportunity to be heard before the local government, and an appeal process pursuant to the Administrative Procedure Act. After completing this process, the agency can submit the debt through the League of Municipalities, the Association of County Commissioners, or another clearinghouse. Funneling the debts through a clearinghouse rather than having each local government submit its own debts will avoid placing an undue administrative burden on the Department of Revenue.

Streamlining of Program: Under existing law, the setoff process requires three notices to the Department by the claimant agency, two notices by the Department to the agency, and two notices to the taxpayer. The act eliminates two of the notices to the Department by claimant agencies and one of the notices by the Department to claimant agencies.

Before the effective date of this act, the procedure is as follows: A State agency notifies the Department of a debt. The Department checks to see if the debtor will be receiving a tax refund. If so, the Department notifies the agency that the debtor is entitled to a refund. The agency then sends the Department and the debtor a notice of intent to apply the refund to the debt. After any hearing requested by the debtor, the agency sends the Department a notice of certification of the debt. The Department then applies the tax refund to the debt and notifies the taxpayer and the agency of the setoff. If the debt is less than the refund, the Department sends the balance of the refund at the same time.

Under the act, a claimant agency sends the Department notice of the debt and the Department immediately sets off the debt against the refund and notifies the taxpayer and the claimant agency. A local agency cannot notify the Department of a debt until after the debt has been established through notice to the debtor and a hearing, if requested. A State agency can notify the Department of a debt, have the refund placed in an escrow for the agency, notify the debtor and hold any hearing requested, and then disburse the escrowed amount accordingly.

The act gives a debtor the same procedural and substantive rights as under existing law, including the right to interest on any part of the refund found not to be a valid debt. Under existing law, a debtor is notified of a potential setoff and the right to contest the setoff. The debtor receives the same notifications under this act. Also, under the act, if an agency fails to give the debtor the required notice, the agency must return the entire refund to the debtor even though a debt is owed.

Collection Assistance Fee Changes: Before the effective date of this act, the cost of administering the setoff debt collection program was paid by the State agencies whose debts were collected by setoff. Under both existing law and this act, each year, the Department of Revenue determines its costs of running the program and recovers these costs by charging a collection assistance fee as a percentage of each debt collected. The act caps this fee at no more than $15.00 per debt. The actual fee is expected to be less.

The act shifts the burden of paying the administrative costs of most setoffs from participating State agencies to the debtors. Under existing law, except in the case of child support debts, the Department of Revenue retained the collection assistance fee from each setoff and reduced the amount paid to the agency by the amount of the fee. The agency therefore absorbed the cost of collecting the debt by receiving less than the full amount of the debt. Under the act, the Department of Revenue still retains the collection assistance fee but the fee is added to the debt and paid by the debtor from the refund rather than subtracted from the amount payable to the agency. As a result, the debtor will pay the fee out of the tax refund that was set off. This change shifts approximately $270,000, which is the cost of collecting about 39,000 debts, from State agencies' budgets to debtors.

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

S.L. 1997-499 (House Bill 537, Representative Grady)

AN ACT TO PROVIDE RELIEF FOR FEDERAL RETIREES AND THE SURVIVING SPOUSES OF FEDERAL RETIREES.

This act provides the following additional relief to federal retirees who paid unconstitutional North Carolina income tax on their federal retirement benefits in 1985, 1986, 1987, and 1988, but did not protest or request a refund within 30 days as required by law:

1. It allows federal retirees to carry forward for two years the unused portion of their tax credit for payment of these unconstitutional taxes if they cannot claim the entire credit because the credit exceeds their tax liability.
2. It allows the surviving spouse of a deceased federal retiree to claim the decedent's tax credit, including the two-year carryforward. If there is no surviving spouse, the decedent's estate may take the credit, but not the two-year carryforward.

The act is effective retroactively to the 1996 tax year. It requires the Secretary of Revenue to reimburse the General Fund for the costs of the additional tax relief by transferring $8 million of excess funds in a reserve account created in 1996.

In 1996, the General Assembly enacted legislation giving federal retirees income tax

credits and partial refunds for the North Carolina income taxes they paid on their federal retirement benefits in 1985, 1986, 1987, and 1988. If a federal retiree paid these 1985-88 pension taxes under timely protest, the retiree already received a refund as required by existing law. The 1996 legislation, estimated to cost the General Fund $117 million over three years, provided relief to nonprotesters, who were not legally entitled to a refund or credit.

The 1996 legislation allowed partial refunds and credits as follows: federal retirees who did not make a timely protest and who would owe North Carolina income tax were authorized to take a State income tax credit equal to the amount of pension taxes they paid. The tax credit was allowed in three equal, annual installments, one for the 1996 tax year, one for the 1997 tax year, and one for the 1998 tax year. For a taxpayer whose 1996 tax liability was less than 5% of the pension taxes the taxpayer paid during 1985-88, a one-time refund equal to 85% of the pension taxes was allowed in lieu of the credit. The taxpayer was required to claim this refund by April 1, 1997. The 1996 legislation provided that if a federal retiree who would otherwise be eligible for a credit or refund had died, the retiree's estate could claim the credit or refund.

After the 1996 legislation was enacted, legislators began receiving complaints that this legislation did not provide sufficient relief for surviving spouses or for retirees who did not have enough current tax liability to claim the entire credit. If a retiree eligible for the first installment of the credit for the 1996 tax year died in 1996 or thereafter, the surviving spouse could not claim any of the remaining installments of the credit. The 1996 legislation authorized the estate to claim the credit, but estates often have little or no tax liability against which a credit could be claimed. This act addresses this complaint by allowing surviving spouses to claim the credit. The other complaint received was from taxpayers who were ineligible for the 85% refund because their tax liability equaled 5% or more of the amount of pension taxes they paid for 1985-88. Those taxpayers might receive a credit equal to anywhere from 15% to 100% of the pension taxes, depending upon whether they had enough tax liability against which to claim the credit. The credit allowed is nonrefundable, i.e., to the extent it exceeds the taxpayer's tax liability, it is lost. Taxpayers with lower liability would receive credit for less than 100% of their pension taxes. This act addresses this complaint by allowing taxpayers to carry the unused portion of the credit forward to the following two tax years: 1999 and 2000.

The legislative history of the 1996 legislation indicates that the General Assembly intended that some taxpayers would not receive 100% credit, either because they died in 1996 or later or because their potential credit exceeded their tax liability against which it could be claimed. In the 1996 Second Extra Session, the Senate and the House of Representatives had different approaches to granting relief to nonprotesters for the taxes they paid on their federal pensions from 1985 through 1988. The House passed House Bill 30 (Rep. Grady), which would have provided a full refund of all taxes paid, through a refundable credit payable over four years. If the retiree died, the surviving spouse or estate was entitled to the refund. The estimated cost of the proposal was a total of $142.8 million. In contrast, the Senate passed a Senate Committee Substitute for House Bill 30 that provided only partial relief for an estimated total cost of $117.7 million. This version of the bill provided only nonrefundable credits and did not provide relief for surviving spouses of deceased retirees. The matter went to conference and the Senate plan prevailed. The two limitations now complained of are the reason the Senate plan cost less than the House plan in 1996.

S.L. 1997-503 (Senate Bill 853, Senator Conder)

AN ACT AUTHORIZING THE SECRETARY OF THE DEPARTMENT OF REVENUE TO APPOINT EMPLOYEES OF THE DEPARTMENT AS REVENUE LAW ENFORCEMENT AGENTS TO ENFORCE THE EXCISE TAXES ON UNAUTHORIZED SUBSTANCES AND THE CRIMINAL PROVISIONS OF THE REVENUE LAWS.

This act authorizes the Secretary of Revenue to appoint employees of the Criminal Investigations Division and the Unauthorized Substances Tax Division as revenue law enforcement officers. An employee must be certified as a criminal justice officer under the N.C. Criminal Justice Education and Training Standards Commission to serve as a revenue law enforcement officer.

The Unauthorized Substances Tax Division officers will have subject-matter jurisdiction to enforce the excise tax on unauthorized substances. The Criminal Investigations Division officers will have subject-matter jurisdiction to enforce the felony tax violations in G.S. 105-236 and to enforce any of the following criminal offenses when they involve a tax imposed under Chapter 105 of the General Statutes: embezzlement of State property, embezzlement of funds, obtaining property by false pretenses, forgery, and uttering forged paper. A revenue law enforcement officer has Statewide jurisdiction within the officer's subject-matter jurisdiction. The officer may serve and execute notices, orders, warrants, or demands issued by the Secretary of Revenue or the courts, and may use the powers of arrest in executing these papers.

As law enforcement officers, these Department of Revenue employees will be entitled to increased pension benefits such as a 5% contribution to a 401(k) plan, early retirement, enhanced compensation for work-related disability, and a separation allowance that increases benefits for an officer who retires before becoming eligible for social security (the allowance ends when the officer begins receiving social security). The act requires the Department of Revenue to use $67,503 of its operating appropriations for the 1997-98 fiscal year to pay for the increased costs.

S.L. 1997-521 (House Bill 1057, Representative Grady)

AN ACT TO EXEMPT FROM SALES TAX AUDIOVISUAL MASTER TAPES USED IN THE MOTION PICTURE, TELEVISION, AND AUDIO PRODUCTION INDUSTRIES.

This act creates a new State and local sales and use tax exemption, effective October 1, 1997. The new exemption is for audiovisual masters. An audiovisual master is the film, tape, or other storage device that is made or used by a production company to make more copies of the film or tape. The act is expected to reduce State sales tax revenues by approximately $1 million in fiscal year 1997-98 and by approximately $1.59 million in fiscal year 1998-99. The act is expected to reduce local sales tax revenues by approximately $500,000 in fiscal year 1997-98 and by approximately $800,000 in fiscal year 1998-99.

Because it is levied on the retail price, the tax at issue in this act applies to the value of all production and post-production work that goes into creating a film, video, or commercial. Assume, for example, that a politician contracts with an advertising agency to have a political commercial made. The agency then films, or contracts with others to film the politician in action. When the filming is completed, the agency contracts with a company to edit the film and put it in a finished form with sound and any narration. When the finished product (the audiovisual master) is delivered by the agency to the politician, a sales tax applies to the sale of that finished product. The tax is computed on the value of all the services that went into the finished product, such as acting fees or other charges.

According to the North Carolina Film Office, most post-production work on films is done in California or New York but the post-production work on commercials and videos is done in many other places. South Carolina and Virginia do not tax audiovisual masters, so a lot of production companies choose to do post-production work on commercials and videos is done in those states. The exemption provided by this act should remove a disincentive for production companies to work in North Carolina.

S.L. 1997-525 (Senate Bill 1065, Senator Hoyle)

AN ACT TO EXPAND THE INCOME TAX EXCLUSION FOR SEVERANCE PAY TO INCLUDE SEVERANCE PAY DUE TO AN EMPLOYEE'S INVOLUNTARY TERMINATION THROUGH NO FAULT OF THE EMPLOYEE.

This act expands the income tax exclusion for severance pay received due to the closing of a manufacturing plant and modifies the cap on the exclusion, effective beginning with the 1998 tax year. It is expected to reduce General Fund revenues by a little more than $2 million in fiscal year 1998-99.

In 1996, the General Assembly enacted an income tax exemption for severance pay a taxpayer receives due to the permanent closure of a manufacturing or processing plant, not to exceed a maximum of $35,000 for the taxable year. The exemption was expected to reduce General Fund revenues by approximately $4 million a year. This act expands the tax exemption to include severance pay received due to any involuntary termination through no fault of the employee. The expanded exemption would include being fired without cause, being laid off due to a reduction in force, as well as being terminated due to a plant closure. It would not include voluntary early retirement or being fired for cause. The act also expands the tax exemption to cover any type of job in the private or public sector, not just a job at a manufacturing plant.

Some taxpayers were able to avoid the $35,000 cap by arranging to receive part of the severance pay in December and the rest in January. The act closes this loophole by clarifying that the $35,000 cap applies to the total amount paid to an employee by an employer for the same termination, regardless of when the taxpayer receives the money.

1996

Prepared by Cindy Avrette, Sabra J. Faires, and Martha H. Harris

1996 Second Extra Session

Chapter 13, 1996 Second Extra Session (House Bill 18, Representative Gray)

AN ACT TO REDUCE TAXES FOR THE CITIZENS OF NORTH CAROLINA AND TO PROVIDE INCENTIVES FOR HIGH QUALITY JOBS AND BUSINESS EXPANSION IN NORTH CAROLINA.

This act is the William S. Lee Quality Jobs and Business Expansion Act. It represents the major tax reduction legislation passed in 1996 by the 1995 General Assembly. The act cuts taxes by $186.5 million in fiscal year 1997-98. This act, coupled with the 1995 tax cuts, reduce taxes by more than $624 million in fiscal year 1997-98. The act does many things: it reduces the sales tax on food, reduces the corporate income tax, provides tax credits for quality jobs and business expansion, phases out the excise tax on soft drinks, modifies the bundled transaction sales tax, reduces inheritance and gift taxes, creates a nonitemizer charitable contribution tax credit, excludes certain severance pay from income tax, and reduces the sales tax on farm and industry fuel. Other major tax cuts were made in Senate Bill 6, ratified as Chapter 14 of the 1996 Second Extra Session, in House Bill 30, ratified as Chapter 19 of the 1996 Second Extra Session, and in House Bill 53, ratified as Chapter 18 of the 1996 Second Extra Session.

Reduce Sales Tax on Food

Under current law, food stamp items that are purchased with food stamps are exempt from both State and local sales taxes, and food stamp items that are not purchased with food stamps are subject to both the State 4% sales tax and the local 2% sales tax. Effective January 1, 1997, this act reduces the State sales tax on food stamp items from 4% to 3% but does not repeal or reduce the local sales tax on these items. This part of the act reduces General Fund revenues by $36.7 million in fiscal year 1996-97 and by $87 million in fiscal year 1997-98.

Federal law determines what can be purchased with food stamps and, therefore, what would be exempt from State sales tax under this act. Food stamps can be used to purchase the following from a retailer that has decided to participate in the food stamp program: food for humans for home consumption, seeds and plants for use in gardens to produce food for human consumption, and certain meals served by meal delivery services and communal dining facilities.

Examples of food items that would be exempt are fruits, vegetables, bread, meat, fish, milk, snack foods such as candy, gum, soft drinks, and chips, distilled water, ice, tomato plants, fruit trees, and cold prepared food for home consumption. Items that are not considered food items under federal law and would therefore remain subject to tax include alcoholic beverages, tobacco products, pet food, prepared foods that are hot at the point of sale and are therefore ready for immediate consumption, such as a broiled chicken kept in a heated display case, and food, such as a hamburger, a pastry, or soup, that is marketed to be heated on the premises of the retailer in a microwave oven or other heating device.

Food has been subject to sales tax in North Carolina since 1961. From the enactment of the sales tax in 1933 until 1961, either essential food items or food purchased for home consumption was exempt, except during the two years from 1935 to 1937.

Reduce Corporate Income Tax

Part II of the act reduces the corporate income tax rate from 7.75% to 6.9% over a four-year period, beginning with tax year 1997. This part of the act is expected to reduce General Fund revenues by $14.2 million in fiscal year 1996-97, $46.2 million in fiscal year 1997-98, $79 million in fiscal year 1998-99, $103.2 million in fiscal year 1999-2000, and $110.2 million in fiscal year 2000-01. The act also adjusts the percentage of corporate tax revenue that is automatically credited to the Public School Building Capital Fund to keep the amount of revenue that goes to this Fund at its current level.

Until 1987, North Carolina's corporate income tax rate was 6% of a corporation's State net income. In 1987, as part of a tax package that included repeal of the property tax on inventories, the corporate income tax was increased to 7%. One-half of the additional 1% was dedicated to public school capital needs. In 1991, as part of a legislative package that cut spending and raised revenues to make up a $1.2 billion shortfall, the corporate income tax rate was increased to 7.75% and a 4% surtax was enacted. The surtax was phased out over four years and expired January 1, 1995.

Quality Jobs and Business Expansion Tax Credits

The act establishes several tax incentives to encourage new and expanding businesses and a general business tax credit that will be more beneficial for small and existing businesses. With the exception of the worker training tax credit, the tax credits become effective for taxable years beginning on or after January 1, 1996, and apply to property placed in service and jobs created on or after August 1, 1996, and to research and development expenditures made on or after July 1, 1996. The worker training credit becomes effective January 1, 1997, and applies to training expenses made on or after July 1, 1997.

All of the credits are allowed against either the franchise tax or the income taxes; they may not exceed 50% of the tax against which they are claimed for the taxable year, and any unused credit may be carried forward for the succeeding five years. It is estimated that the credits will reduce General Fund revenues by more than $19 million in fiscal year 1997-98; this loss will increase to more than $72 million by fiscal year 2000-01. Reports will be submitted each year detailing the number of credits claimed, the number of new jobs created, the cost of tangible personal property with respect to which credits were claimed, and the costs to the General Fund of the credits claimed. The credits will expire January 1, 2002.

The tax incentives for new and expanding businesses were part of the Governor's proposals for economic development and were designed and recommended by the Governor's Economic Development Board. They include expansion of the current jobs tax credit and establishment of new tax credits for worker training expenses, for increasing research activities, and for investing in machinery and equipment. To be eligible for the credits, a taxpayer must engage in manufacturing or processing, warehousing or distributing, or data processing and the jobs must pay at least 10% above the average weekly wage in the county where the job is created.

The act expands the current jobs tax credit to include all 100 counties, to include data processing and warehousing and distribution jobs, to include employers with five or more employees, to apply to corporate franchise tax as well as corporate and individual income tax,

and to significantly increase the amount of the credit for the most distressed counties. The current credit applies to 50 counties, is limited to manufacturing and processing jobs, is limited to employers with nine or more employees, is limited to corporate and individual income tax, and is a set amount ($2,800) in all 50 counties. The act divides the counties into five "enterprise tiers" based on their per capita income, unemployment rate, and population growth. The ten poorest counties are in tier one and the next fifteen counties are in tier two. The remaining seventy-five counties are divided evenly among tiers three, four, and five. The jobs tax credit is $12,500 for each eligible new job created in an enterprise tier one area, $4,000 in a tier two area, $3,000 in a tier three area, $1,000 in a tier four area, and $500 in a tier five area.

The worker training tax credit applies to expenses to train an employee for whom a jobs tax credit is allowed. The credit is 50% of the eligible training expenses, not to exceed $1,000 per worker in enterprise tier one counties and $500 per worker in other counties. The eligibility of training expenses is certified by the Community College system based on existing requirements for State-funded training for new and expanding industry.

The research and development tax credit uses the federal credit as its starting point. The credit is equal to 5% of eligible expenses incurred in North Carolina. Congress has reenacted the federal research and development credit for the period July 1, 1996, to June 30, 1997.

The credit for investment in machinery and equipment applies to property placed in service in this State and capitalized by the taxpayer for tax purposes under the Code. The credit is 7% of the cost of the taxpayer's net new investment that exceeds the county's threshold amount. The threshold amount varies depending on the county's enterprise tier, as indicated in the following table:

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

The credit must be taken in seven equal installments, beginning the year after the equipment is placed in service.

The act also provides a tax credit for investing in tangible personal property that is used by the taxpayer in connection with a business or for the production of income and is capitalized by the taxpayer for tax purposes under the Code. The amount of the credit is 4.5% of the cost of the property placed in service, not to exceed $4,500 per taxpayer per year. The credit must be taken in five equal installments beginning in the year the property is placed in service. This credit is less restricted than the credit for investment in machinery and equipment in that there is no minimum wage requirement, no minimum amount of investment requirement, and no type of business requirement.

The act provides several benefits for the ten poorest counties, which are in enterprise tier one. These counties will have access to a special Utility Account within the Industrial Development Fund of the Department of Commerce. The General Assembly appropriated $2 million to this account in the Current Operations Appropriations Act of 1996. The money in the

Utility Account can be used for construction or improvements to new or existing water, sewer, gas, or electrical utility distribution lines or for existing, new, or proposed industrial buildings to be used in manufacturing and processing, warehousing and distribution, or data processing. Enterprise tier one counties will also be exempt from local match requirements for Industrial Development Fund grants and loans and Community Development Block Grants Economic Development grants and loans. To the extent practical, they will receive priority consideration for Community Development Block Grant Economic Development financing.

The act also expands the Industrial Development Fund program in all counties by increasing the maximum grant or loan from $2,400 per job to $4,000 per job, and from $250,000 per project to $400,000 per project. Finally, the act directs the Department of Commerce to annually review the level of development in each of the State's multi-county economic regions and to strive for balance and equality of development within each region.

Phase Out Soft Drink Tax

During the 1995 Regular Session, the General Assembly reduced the excise tax on soft drinks by 25%, effective July 1, 1996. This act continues the reduction started in 1995 by phasing out the tax over a three-year period, beginning July 1, 1997. This part of the act, when fully implemented in fiscal year 1999-2000, is expected to reduce General Fund revenues by $31.8 million.

The soft drink excise tax was enacted in 1969. The purpose of the tax is to provide an additional source of revenue to the General Fund. A soft drink is defined as a beverage that is not an alcoholic beverage. An alcoholic beverage is a beverage containing at least 0.5% alcohol.

Modify Bundled Transaction Sales Tax

This part of the act specifies how the amount of State and local sales and use tax due on a "bundled transaction" is to be calculated. Its primary application is in the taxation of cellular phones transferred at no cost or substantially below cost in conjunction with agreements to obtain cellular phone service for a specified minimum period of time. The provision becomes effective November 1, 1996, and is expected to reduce General Fund revenues by $6.7 million a year and local government revenues by $3.3 million a year.

As defined in the act, a "bundled transaction" is one in which an item, such as a cellular phone, is transferred without charge or below the seller's cost on condition that the purchaser enter into an agreement to purchase services for at least six months and to pay a cancellation fee if the purchaser cancels the service agreement before the end of the minimum period. Under current law, when an item is transferred in a bundled transaction, the seller is liable for use tax computed on the wholesale cost of the item. If, for example, a retailer gives a phone away in conjunction with a service agreement or sells a phone for $1 in conjunction with a service agreement and the wholesale cost of the phone to the retailer is $100, a tax of $6 (6% of $100) is due. To base the tax due on the amount charged for the item would produce the anomalous result that $6 use tax is due if the retailer gives the phone away but only 6¢ sales tax is due if the retailer "charges" $1 for the phone.

Under the act, tax is due on any price, such as $1, charged for the item when the transaction occurs and is due on the difference between the price charged and the normal retail price of the item only if the services the purchaser agrees to receive are not subject to a tax of at least 6%. If the services the purchaser agrees to receive are subject to a tax of at least 6%, no tax is due on the balance of the retail price of the item transferred unless the purchaser

cancels the service agreement and is required to pay the cancellation fee. If this occurs, tax is due on the amount of the cancellation fee.

The effect of the act is to exclude part or all of the retail price of a cellular phone from sales and use tax when the phone is transferred in a bundled transaction. This would occur because telephone service is subject to a tax of at least 6% (State sales and use tax combined with State gross receipts franchise taxes). Cellular phones sold in transactions that are not bundled with service agreements would continue to be subject to State sales and use tax based on the retail price and the telephone service acquired to use the phone would also be taxed. Thus, under the act, if a person is charged $1 in a bundled transaction for a cellular phone that has a wholesale value of $100 and a retail value of $160, the person will pay tax of 6¢ (6% of $1). If that person buys the same phone in a transaction that is not bundled, the person will pay tax of $9.60 (6% of $160). Under current law, the person would pay $6 tax in the bundled transaction and $9.60 in the unbundled transaction.

Reduce Inheritance and Gift Taxes

This part of the act increases the Class A inheritance tax credit from $26,150 to $33,150, adopts the federal estate and gift tax provisions on qualified terminable interest trusts, prevents a double deduction for certain administrative expenses, and allows for the installment payment of inheritance taxes on closely held businesses and farms. The inheritance and gift tax changes become effective January 1, 1997, and apply to the estates of decedents dying on or after that date and to gifts made on or after that date. The changes are expected to reduce General Fund revenues by $3.5 million a year beginning in fiscal year 1997-98.

North Carolina inheritance and gift tax rates are based on the relationship of the person transferring the property to the person receiving the property. State law classifies beneficiaries into three classes, Class A, Class B, and Class C, and sets different tax rates for each class. A Class A beneficiary is a lineal ancestor, a lineal descendant, an adopted child, a step-child, or a son-in-law or daughter-in-law whose spouse is not entitled to any of the decedent's property; a Class B beneficiary is a sibling, a descendant of a sibling, or an aunt or uncle by blood; and a Class C beneficiary is anyone who is not a Class A or Class B beneficiary. Class A beneficiaries have the lowest tax rates, Class B beneficiaries have higher rates, and Class C beneficiaries have the highest rates. Thus, North Carolina's rate structure favors transfers to children and parents by giving these transfers the lowest rates and prefers transfers to other close family members over transfers to more distant relatives or to persons who are not related by giving these transfers the in-between rate.

North Carolina's inheritance and gift tax laws are in contrast to federal law, which has a single rate schedule for gifts and estates. As under federal law, however, all transfers to a spouse are exempt from State inheritance and gift taxes. The Revenue Laws Study Committee recommended to the 1996 General Assembly that the current inheritance tax be phased out over five years and that the federal "pick-up" tax, which is the federal state death tax credit, be retained as the State estate tax.

The 1996 General Assembly did not choose to phase out the tax, but it did increase the Class A beneficiary inheritance tax credit so that the amount exempted by the credit would be the same as the amount that is exempted from federal estate and gift taxes by application of the federal unified credit. The federal unified credit is $192,800, which exempts $600,000 of property from federal estate or gift taxes. The federal credit is unified in that it applies to both federal estate and gift taxes. Any part of the credit that is not used on gift taxes is applied to estate taxes.

The State Class A inheritance tax credit is not a unified credit. It does not apply to State gift taxes. State law provides a separate $100,000 lifetime exemption for gifts made to Class A beneficiaries. Under current law, therefore, the combination of the State gift tax lifetime exemption for Class A beneficiaries and the Class A inheritance tax credit exempts the same amount of property as the federal unified credit. Under this act, the increase in the Class A inheritance tax credit to $33,150 will exempt an additional $100,000 from inheritance tax. If a person fully uses both the State $100,000 gift tax lifetime exemption and the State Class A inheritance tax credit, the person can exempt more property from gift and inheritance taxes under State law than under federal law.

The act further conforms to federal law by exempting from State inheritance and gift tax property that is exempt from federal estate and gift taxes because it is considered qualified terminable interest property (QTIP property). Conforming to federal law on this topic will provide consistent treatment at the federal and State level. Also, because this type of property is more like an outright transfer to a spouse than it is like any other kind of transfer, this act intends to further the State's policy of exempting transfers to spouses from inheritance or gift tax by providing that no inheritance tax will be due until the spouse subsequently dies and passes the property on to the ultimate beneficiaries.

QTIP property is property placed in a trust in which a person's spouse has an income interest for life and the person's children or other designated beneficiaries have a remainder interest. Under federal law, a transfer of property that qualifies as QTIP property is not taxable when the transfer is made. Instead, it is taxed when the spouse who had the lifetime income interest in the property dies. At that time, the value of the QTIP property is included in the spouse's gross estate.

Under current North Carolina law, when property is transferred by means of a QTIP trust, two transfers are considered to have been made. One transfer is the transfer to the spouse of a life estate in the trust income. The transfer of the life estate to the spouse is not taxed because all property that passes to a spouse is exempt from State inheritance and gift taxes. The value of the spouse's life estate is the present value of the stream of income based on the life expectancy of the spouse. The other transfer is a transfer of the remainder interest in the trust property to the transferor's children or other designated beneficiaries. The transfer of the remainder interest is subject to inheritance or gift tax. The value of the remainder interest is its present value as of the date of death or date of the gift.

Under this act, the remainder interest in QTIP property would no longer be taxable under North Carolina law when the QTIP trust is established. Instead, it would be taxable when the spouse with the life estate in the income died and would be taxed on the basis of the value at the spouse's death. In some cases, taxes would be collected at a later time than under current law, but in other cases less tax would be collected than under current law. Further reductions in tax would occur if the value of the trust property declined over time. No tax would be collected at a later date if the spouse moved out of the State before death and the trust consisted of securities rather than real property located in the State. By the same token, some tax would be collected that is not now collected if a spouse with a QTIP trust moves into the State.

A QTIP trust need not be established before a gift is made or the decedent dies. If the transfer is a gift, the trust can be established any time before the gift tax return is filed. If the transfer is a devise upon death, the trust can be established any time before the estate tax return is due if the will gives the personal representative the option of establishing a QTIP trust. The decision of whether or not to establish a QTIP trust is made after considering tax consequences and other factors.

Current law allows the costs of administering an estate to be deducted when determining the amount of inheritance tax payable on property in the estate. Costs of administration include attorney fees, accountant fees, and executor fees. The law, however, does not limit the inheritance tax deduction to costs that are not deducted on a fiduciary income tax return filed for the estate. If the same cost is deducted on both returns, the taxpayer receives an unintended double deduction for the same item.

A double deduction for the same item of cost is most likely to result when, because of the small size of an estate, no federal estate tax return is filed but a federal fiduciary income tax return is filed. In this instance, all costs will be deducted on the federal fiduciary income tax return.

North Carolina's income tax uses federal taxable income as the starting point in computing North Carolina taxable income. A result of this is that deductions taken on the federal return are automatically passed through on the North Carolina return. Thus, any item that is deducted on the federal fiduciary income tax return is also deducted on the State fiduciary income tax return. To prevent a double deduction, this act prohibits the deduction of an item on an inheritance tax return if the item was deducted on the federal fiduciary income tax return.

Finally, this part of the act allows for the installment payment of inheritance taxes on closely held businesses and farms if the personal representative of the estate elects under section 6166 of the Internal Revenue Code to make annual installment payments of federal estate tax. Payments are due at the same time and in the same proportion to the total tax due as payments due to the Internal Revenue Service under section 6166 of the Code. An acceleration of federal payments will also accelerate the North Carolina payments.

Nonitemizer Charitable Contribution Tax Credit

This part of the act creates an individual income tax credit for charitable contributions made by individuals who do not itemize their deductions. The credit is 2.75% of the amount of charitable contributions that exceed 2% of the individual's adjusted gross income. Two percent is the average percentage of income that North Carolinians contribute to nonprofits. By setting the floor at 2%, the act encourages and acknowledges giving that is above average. It is effective for taxable years beginning on or after January 1, 1997, and is expected to reduce General Fund revenues by approximately $5 million a year.

Under the federal Internal Revenue Code, an individual who itemizes deductions may deduct contributions to nonprofit charitable organizations. Individuals who elect the standard deduction, however, may not deduct charitable contributions. An individual's North Carolina's income tax is based on the federal calculation of taxable income, with some adjustments. The federal disallowance of charitable deductions for nonitemizers is "piggybacked" by North Carolina tax law, so there is no income tax incentive under federal or North Carolina law for nonitemizers to make charitable contributions. Legislation was introduced in Congress to allow nonitemizers to deduct charitable contributions. If federal legislation were enacted, North Carolina could "piggyback" the federal tax incentive. However, the federal legislation did not pass.

Individuals who elect the standard deduction are those whose total itemized deductions (such as mortgage interest, State and local property and income taxes, medical expenses, and charitable contributions) do not exceed the standard deduction amount. The amount of the standard deduction varies depending upon the individual's filing status. The North Carolina standard deduction amounts for 1996 are $5,000 for a married couple filing a joint return; $4,400 for a head of household; $3,000 for single taxpayer; and $2,500 for a married

taxpayer filing separately. Approximately 71% of North Carolina taxpayers elect the standard deduction.

This provision was one of the recommendations of the House of Representatives' Select Committee on Nonprofits; it is intended to increase charitable giving. The Committee studied the question of whether tax incentives make a difference in charitable giving and learned that federal tax incentives probably do but State tax incentives probably do not because the State income tax is so low compared to the federal income tax that it does little to influence individuals' economic decisions. The Committee believed, however, and the General Assembly agreed, that State incentives may affect perceptions, and thus behavior, even if the tax is too small to provide a significant economic incentive.

Exclude Certain Severance Pay from Income Tax

This part of the act exempts from State individual income tax severance pay a taxpayer receives due to the permanent closure of a manufacturing or processing plant, not to exceed a maximum of $35,000 for the taxable year. This part is effective for taxable years beginning on or after January 1, 1996. The exemption is expected to reduce General Fund revenues by approximately $4 million a year.

Reduce Sales Tax On Fuel Used By Farmers and Industry

This part of the act reduces the sales tax rate on electricity and piped natural gas used by farmers, manufacturers, laundries, and dry cleaners from 3% to 2.83%, effective August 1, 1996. This change affects General Fund revenue but not local revenue because no local sales tax applies to electricity and piped natural gas. It is expected to reduce General Fund revenue by over $5 million dollars a year.

Chapter 14, 1996 Second Extra Session (Senate Bill 6, Senator Kerr)

AN ACT TO PROVIDE TAX REFORM AND TAX RELIEF FOR THE CITIZENS OF NORTH CAROLINA BY REPEALING THE UNCONSTITUTIONAL CORPORATE TAX CREDIT FOR NORTH CAROLINA WINE, REPEALING THE UNCONSTITUTIONAL CORPORATE TAX DEDUCTION FOR NORTH CAROLINA DIVIDENDS, REPEALING THE UNCONSTITUTIONAL INDIVIDUAL INCOME TAX CREDIT FOR NORTH CAROLINA DIVIDENDS, REVISING THE UNCONSTITUTIONAL TAX CREDIT FOR QUALIFIED BUSINESS INVESTMENTS, CLARIFYING THE TAX TREATMENT OF REFUNDS OF UNCONSTITUTIONAL TAXES, CLARIFYING THE SALES AND USE TAX TREATMENT OF ITEMS GIVEN AWAY BY MERCHANTS, PROVIDING THE SECRETARY OF REVENUE AUTHORITY TO IMPROVE USE TAX COLLECTION, EXEMPTING FROM SALES AND USE TAX INVENTORY THAT IS DONATED BY A MERCHANT TO A CHARITABLE NONPROFIT ORGANIZATION, AND REPEALING MOST STATE PRIVILEGE LICENSE TAXES.

This act contains several different provisions recommended to the 1995 General Assembly by the Revenue Laws Study Committee. It repeals or revises four North Carolina tax provisions that the Committee identified as having the same flaw as the intangibles tax stock deduction that was declared unconstitutional by the United States Supreme Court in the Fulton[1237] decision. In addition, it clarifies the tax treatment of refunds of unconstitutional taxes, extends the time a taxpayer has to challenge the unconstitutionality of a tax from 30 days to one year, enables the State to enter into agreements to accept voluntary payments of State

[1237] Fulton Corp. v. Faulkner, 516 U.S. 325, 116 S. Ct. 848, 133 L. Ed. 2d 796 (1996).

and local use tax, directs the Department of Revenue to instruct mail-order companies to obtain the purchaser's county of residence for proper allocation of use tax revenue, clarifies the sales tax treatment of items given away by merchants, exempts from sales and use tax tangible personal property that is donated by a manufacturer or retailer to a nonprofit organization for a charitable purposes, and repeals most State privilege license taxes. The act results in a revenue gain for the General Fund of approximately $18.27 million in fiscal year 1996-97. After the privilege license repeal becomes effective in 1997, the act will increase General Fund revenues by only about $2 million a year.

Unconstitutional Tax Preferences

The tax preferences addressed in Part I of the act are:

1. The current $300 individual income tax credit for dividends received from North Carolina companies: Effective for the 1996 tax year, the act repeals this credit.
2. The $15,000 corporate income tax deduction for dividends received from North Carolina companies: Effective for the 1996 tax year, the act repeals this deduction.
3. The income tax credits for investing in North Carolina Enterprise Corporations and for qualified business investments in North Carolina companies: The act repeals the credit for investing in North Carolina Enterprise Corporations and the corporate income tax credit for qualified business investments, effective for investments made on or after January 1, 1997. It restricts the remaining tax credits for qualified business investments to those made by individuals or small partnerships directly in qualified businesses and removes the requirement that qualified businesses be headquartered and operating in North Carolina, effective for investments made on or after January 1, 1997. It also caps the credits at $6 million a year, effective for investments made on or after January 1, 1996.
4. The North Carolina income tax credit for distributing North Carolina wine: The act repeals this credit effective for the 1996 tax year.

There is no disagreement on whether these tax preferences are flawed. The Attorney General's Office advised the Department of Revenue that, if the General Assembly did not resolve the constitutional problems with these preferences, the Department of Revenue had the option of either denying the preferences to North Carolina companies or extending the preferences to all out-of-state companies. Enforcing the preferences as written on the books was not an option because of the risk of personal liability on the part of Department of Revenue personnel in enforcing provisions that were so clearly flawed in the wake of the Fulton decision.

One unconstitutional tax preference identified by the Revenue Laws Study Committee that is not addressed in this act is the 100% deduction allowed to North Carolina parent companies for subsidiary dividends received by them with no requirement that expenses be deducted from the tax-free income. Out-of-state parent companies are allowed an exclusion for subsidiary dividends but are required to adhere to the basic tax principle that expenses incurred to generate the tax-free dividend income cannot also be deducted. The Revenue Laws Study Committee recommended revising this preference to apply the basic tax principle to in-state parent companies. However, this provision is omitted from this act. Inaction on this item by the General Assembly will result in a revenue loss of approximately $3.5 million annually because the Department of Revenue will probably extend the current preference for in-state parents to out-of-state parents.

Part I of this act also extends the time a taxpayer has to challenge the unconstitutionality of most taxes from 30 days to one year, effective for taxes paid on or after November 1, 1996. The time limit remains at 30 days for excise taxes on alcoholic beverages, soft drinks, tobacco products, and controlled substances. In North Carolina, if a taxpayer believes a tax is unconstitutional, the taxpayer must pay the tax and contest the tax by requesting a refund within 30 days after paying the tax. This procedure is known as "paying under protest". The North Carolina Supreme Court has upheld the constitutionality of the State's 30-day rule and the United States Supreme Court, by deciding not to hear the case, upheld the State court's ruling.

States that require a taxpayer to contest a tax by paying under protest are called "postdeprivation remedy" states. Most postdeprivation remedy states have a statute of limitations that is longer than 30 days. The most common statute of limitations utilized by the postdeprivation remedy states is known as the "three-year/two-year" rule. Under this rule, in order for a taxpayer to recover a refund of money paid under a tax later declared to be illegal, the taxpayer must have filed for a refund within three years after the date that the taxpayer filed the return, or two years after the date the taxpayer paid the tax, whichever is later. South Carolina recently repealed its 30-day rule and replaced it with a three-year rule.

Finally, Part I of this act clarifies the tax treatment of refunds of unconstitutional taxes and other similar recoveries. Under Section 111 of the Code, if a taxpayer recovers an amount that the taxpayer had previously deducted, the taxpayer must add the amount of the recovery back to gross income. The typical example is a State income tax refund, which must be included in gross income if the taxpayer deducted it as an itemized deduction. The principle is that if the taxpayer received a tax benefit from deducting an expenditure, when the expenditure is refunded to or recovered by the taxpayer, the taxpayer should give back the corresponding tax benefit. This adjustment normally carries through from the Code to North Carolina income tax statutes because North Carolina piggybacks the Code. In some situations, such as the alternative minimum tax, however, North Carolina does not piggyback the Code. A refund or recovery might represent a tax benefit under the Code but not North Carolina law, or vice versa. This part of the act provides consistency in requiring State add-backs of only those refunds and recoveries that represent State tax benefits. It prevents situations in which a taxpayer would receive a double deduction or be subject to double taxation because a refund (of an unconstitutional tax, for example) represented a tax benefit under the Code but not State law, or vice versa.

Sales and Use Tax

Part II of this act makes three changes to the State's sales and use tax laws, effective August 1, 1996:

1. It enhances compliance and enforcement of existing sales and use tax laws by authorizing the Department of Revenue to enter into agreements to accept voluntary payments of State and local use tax and by directing the Department of Revenue to instruct mail-order companies to obtain the purchaser's county of residence for proper allocation of use tax revenue.
2. It clarifies the sales tax treatment of items given away by merchants.
3. It exempts from sales and use tax tangible personal property that is donated by a manufacturer or retailer to a nonprofit organization for a charitable purpose.

The State cannot require a mail-order marketer to collect and remit the use tax owed this State on sales to North Carolina residents unless the marketer has a store in North Carolina or other ties sufficient to give the State jurisdiction over it. If the direct marketer does business with North Carolina residents only through telephone, mail, and freight transactions, it does not have "nexus" with this State and is not required to collect the tax. The United States Supreme Court has held that states' efforts to require these out-of-state marketers to collect sales or use tax on sales to residents violate the interstate commerce clause of the United States Constitution.

As a result of these constitutional restrictions, out-of-state direct marketers have a competitive advantage over in-state merchants, and states lose significant amounts of revenue. Some direct marketers collect and remit use taxes voluntarily as a convenience to their customers. The Direct Marketers Association, the Federation of Tax Administrators, and the Multi-state Tax Commission are currently negotiating a possible agreement under which more direct marketers would voluntarily collect use tax on behalf of customers in states in which the marketers do not have nexus. Under this agreement, tax collection would be simplified by using the same form and payment deadlines in every state. In addition, the direct marketers would collect at only one rate per state; non-uniform county and city rates would be disregarded. If these parties are able to design a system that would be acceptable to all involved, North Carolina would need authority to enter into such an agreement. The act would provide that authority and set out some of the parameters for the agreement. If the ongoing negotiations result in a viable multi-state program for collection of use taxes by direct marketers and North Carolina enters into agreements pursuant to the program, the Department of Revenue could potentially collect millions of dollars in use taxes that are owed under current law but are not being paid.

The act also clarifies the sales tax treatment of items given away by merchants. It provides that property given away or otherwise used by a merchant is not exempt from use tax, except in the case of restaurants and caterers that give free meals to employees or free bar food to patrons and in the case of retailers that give a free item of inventory to a customer on the condition that the customer purchase similar or related property. As under former law, free books of matches would not be subject to use tax if they are given away along with the sale of cigarettes; matches given away where cigarettes are not sold would remain subject to use tax.

A general sales and use tax principle is that a wholesale merchant or retailer who gives away products free of charge instead of selling them is liable for use tax on the products. The use tax, first enacted in 1939, is the complement of the sales tax and applies to the storage, use, or consumption in this State of tangible personal property. A merchant is liable for the use tax on property it uses in its business, whether furniture, equipment, decor, or promotional giveaways. Items sold by a merchant, however, are not subject to use tax because sales tax will apply when the items are sold at retail.

There are some gray areas in determining whether a product is sold or is given away. For example, if a merchant has a "buy one, get one free" sale, both items are considered sold for the price of the first one. Although the second item appears to be given away, in fact both items are being sold at a discounted price. Another example is paper napkins, catsup, and other items that accompany and are consumed along with meals. These items are considered sold as part of the meal.

Until 1993, the following items were considered used, not sold, and thus subject to use tax: meals provided free to the merchant's employees, food given away to the merchant's patrons, and matches given away to patrons, other than matches given along with the sale of

cigarettes. A group of restaurants appealed the assessment of this tax, claiming that in their case these items should be considered sold. The restaurants were selling meals to patrons and, at the same time, giving some of the food to employees as meals and some to patrons as "bar food" such as chips. In addition, free books of matches were provided to patrons for use in the restaurant.

The North Carolina Court of Appeals agreed with the restaurants that these items should be considered sold along with the food the restaurant sold as part of its business. In its opinion, the court reasoned that the cost of these items was recovered by the sale of other items. This rationale could arguably be applied in a very broad way to mean that the cost of all of a merchant's purchases should be exempt from sales and use tax because they are covered by the price of sold items; a merchant's profits from its sales generate the funds to purchase furniture, equipment, decorations, and other items. Thus, taken literally, the court ruling could be interpreted to eliminate the use tax altogether for merchants.

Finally, Part II of the act includes a new sales and use tax exemption for tangible personal property that is donated to a nonprofit organization by a retailer or a wholesale merchant. Under current law, medicine and certain food donated to a nonprofit organization to be used for a charitable purpose are exempt from sales and use tax. This act repeals these two exemptions since they become redundant in light of the new, and broader, exemption created by it.

Under current law, a wholesale merchant or retailer who donates products to a nonprofit organization instead of selling them is liable for the sales and use tax. A wholesale merchant or retailer does not pay sales or use taxes when purchasing the products or the ingredients used to manufacture the products because the products are to be resold. Sales and use taxes do not apply to property purchased for resale or ingredients purchased to manufacture products for resale. If the wholesale merchant or retailer chooses not to sell the goods, the wholesale merchant or retailer becomes liable for use tax on the goods because the resale exemption no longer applies. This is true no matter what the company chooses to do with the products. The act eliminates this liability for use tax by providing a specific exemption for tangible personal property purchased or manufactured by a wholesale merchant or retailer for resale and then withdrawn from inventory and donated to a nonprofit organization, contributions to which are deductible as charitable contributions for federal income tax purposes.

Repeal of Most Privilege License Taxes

Part III of this act repeals most of the State privilege license taxes imposed under Article 2 of Chapter 105 of the General Statutes, effective July 1, 1997. This Part is expected to reduce General Fund revenues by about $11 million a year. The only privilege taxes retained are the taxes imposed by G.S. 105-37.1 (amusements); 105-38 (circuses and similar shows); 105-41 (professionals); 105-83 (installment paper dealers); 105-88 (loan agencies or brokers); 105-102.3 (banks); and 105-102.6 (newsprint publications). The tax on professionals was retained because its repeal would reduce General Fund revenues by more than $3 million a year. The other taxes were retained because they have a gross receipts or other variable element (amusements, circuses, installment paper dealers, banks), are related to a tax that is retained (loan agencies), or were enacted for a regulatory purpose (newsprint publications).

The act preserves the status quo on privilege license taxation for cities and counties. Cities have general authority to impose privilege license taxes unless limited by Article 2; counties have no general authority to impose these taxes but are authorized by Article 2 to levy some specific taxes. The act provides that the current limitations and authorizations in Article 2

that apply to cities and counties will continue to apply. The act also preserves the itinerant merchant regulatory provisions but moves them to Chapter 66 of the General Statutes, Commerce and Business.

The Revenue Laws Study Committee found that the privilege license tax structure in Article 2 of Chapter 105 of the General Statutes is outmoded, inefficient, and not designed on proper principles of taxation such as tax fairness, ability to pay, responsiveness to growth, or administrative cost. There is no rationale for a tax on the privilege to work that applies only to a limited portion of businesses or the work force and that has a different and inconsistent tax rate for each different class of business. Because the tax is not indexed to any economic parameter, the cost to administer the tax has become increasingly high over time compared to the amount of tax collected. As a result, the tax has become more of a nuisance tax than a properly designed source of revenue for the State. The Revenue Laws Study Committee plans to study the elimination of the remaining State privilege license taxes and reform of the provisions governing local privilege license taxes.

Chapter 18, 1996 Second Extra Session (House Bill 53, Representative Holmes)

AN ACT TO MODIFY THE CONTINUATION BUDGET OPERATIONS APPROPRIATIONS ACT OF 1995, AND THE EXPANSION AND CAPITAL IMPROVEMENTS APPROPRIATIONS ACT OF 1995, AND TO MAKE OTHER CHANGES IN THE BUDGET OPERATION OF THE STATE.

The Current Operations Appropriations Act of 1996 contains five tax law changes. It increases the property tax homestead exemption, modifies the State ports tax incentive, exempts milk drinks from the excise tax on soft drinks, allows the University of North Carolina Hospitals at Chapel Hill an annual refund of sales and use tax paid, and makes permanent the quarterly distribution of a portion of the excise tax on wine to the North Carolina Grape Growers Council.

The act expands the homestead exemption amount from $15,000 to $20,000 and increases the income eligibility amount from $11,000 to $15,000, effective for taxes imposed for taxable years beginning on or after July 1, 1997. Under the act, the State will reimburse the counties and cities 50% of the loss they incur as a result of these tax law changes for two years. This reimbursement will cost the General Fund $3 million a year. The increase in the income eligibility amount will allow as many as 34,000 elderly and disabled homeowners to qualify for the homestead exemption who do not currently qualify. The increase in the homestead exemption amount will provide additional property tax relief to at least 155,000 elderly and disabled homeowners who currently qualify for the exemption.

The homestead exemption is a partial exemption from property taxes for the residence of a person who is either aged 65 or older or totally disabled and has an income of less than $11,000. The current exemption amount is $15,000. The exemption amount was last increased in 1993, when it was increased from $12,000 to $15,000. The income eligibility amount was last increased in 1987, when it was increased from $10,000 to $11,000. The income used to determine the income eligibility amount includes moneys received from every source other than gifts or inheritances received from a spouse, lineal ancestor, or lineal descendant. For married applicants residing with their spouses, the income of both spouses is included, whether or not the property is in both names.

The revenue loss associated with this act will be borne equally between the local governments and the State for the first two years. Prior to 1987, local governments absorbed most of the cost of the homestead exemption. From 1987 to 1991, the State reimbursed counties

and cities for 50% of their losses from the homestead exemption. In 1991, the General Assembly froze the amount of reimbursements made to local governments to the amount each city and county was entitled to receive in 1991. That amount is approximately $7.9 million. No additional reimbursement was provided when the exemption amount was increased in 1993.

The act expands the State ports income tax credit to include the importing and exporting of forest products at the State-owned port terminal at Wilmington, effective for taxable years beginning on or after January 1, 1996. Forest products are a type of bulk cargo. Under current law, a taxpayer is not entitled to the income tax credit for bulk cargo imported or exported at the Wilmington terminal. This part of the act is expected to reduce General Fund revenues by $180,000 for fiscal year 1996-97.

Bulk cargo is a type of commodity that is loose and usually stock-piled. Examples of this type of commodity include coal, grain, salt, and wood chips. Break-bulk cargo and container cargo are different methods used to ship the same type of commodity. Commodities that are packaged in a metal trailer box that can be locked onto a tractor-trailer chassis and then detached and put on a ship without any other handling are considered "container cargo". Commodities that are packaged and stored on pallets or in cases that must be handled and stacked onto a ship by hand, crane, etc., are considered break-bulk cargo. Break-bulk cargo also includes machinery.

Under prior law, the income tax credit was available only for break-bulk cargo and container cargo imported or exported at the Wilmington terminal. The credit is available for bulk cargo, break-bulk cargo, and container cargo imported or exported at the Morehead City terminal. Since bulk cargo is generally imported and exported only at the Morehead City terminal, there has not been a need to extend the credit to this type of cargo at the Wilmington terminal. The credit is being narrowly extended to forest products because there is a customer at the Wilmington terminal who will be exporting wood chips and the Ports Authority believes all users of the Wilmington terminal should be entitled to the credit. The act does not extend the credit to all bulk products because the Wilmington terminal does not want to be seen as competing unfairly with other terminals located in the Wilmington area that import or export other types of bulk products.

The amount of the tax credit allowed is equal to the amount of charges paid to the North Carolina Ports Authority in the taxable year that exceeds the average amount of charges paid to the Authority for the past three years. The credit is limited to 50% of the tax imposed on the taxpayer for the current year. Any excess credit may be carried forward and applied to the taxpayer's income tax liability for the next five years. The cumulative credit may not exceed one million dollars per taxpayer. The credit will expire in 1998.

The act also removes the requirement that a flavored milk drink must be registered with the Department of Revenue before it can be exempt from the excise tax on soft drinks and extends the exemption to cover all soft drinks that contain milk. This part of the act is effective retroactively to October 1, 1991. The act does not result in a significant revenue loss because:

1. Any assessments pending against a dairy that produces a flavored milk drink have not been paid and will not have to be paid under the provisions of this act.
2. Other registered flavored milk drinks are currently exempt and therefore are not paying any tax.

Under prior law, a flavored milk drink containing at least 35% milk was exempt from the excise tax on soft drinks if it was registered with the Department of Revenue. Natural liquid

milk produced by a farmer or a dairy has always been exempt from tax without the necessity of registering the milk product. The Department of Revenue assessed tax on some dairies' chocolate milk products because they were not registered with the Department. The dairies contested the assessments.

As originally introduced, this provision would have exempted from the registration requirement chocolate flavored milk produced by a dairy. This approach raised some legal concerns, however, because it resulted in similarly situated taxpayers being treated differently. For example, one flavored milk drink registered with the Department is produced by three different people: a dairy in North Carolina, a dairy located outside the State, and a packer in North Carolina. Under the original provision, the two dairies would not have to register the milk drink to receive the tax exemption and the packer would. To avoid possible litigation, this provision was revised to exempt all milk products from the tax. Under Chapter 13 of the 1995 Session Laws, 1996 Second Extra Session, the excise tax on all drinks will be repealed effective July 1, 1999.

Fourthly, the Current Operations Appropriations Act of 1996 allows The University of North Carolina Hospitals at Chapel Hill to seek an annual refund of State and local sales and use tax they paid on direct purchases of tangible personal property. Sales and use tax liability indirectly incurred by the hospitals on building materials, supplies, fixtures, and equipment that become a part of or annexed to a building used by the hospitals is considered paid on a direct purchase by the hospitals. This part of the act becomes effective January 1, 1997, and applies to taxes paid on or after that date. It is expected to reduce General Fund revenues by $1.9 million in the 1997-98 fiscal year and about $4 million annually thereafter.

Under current law, nonprofit, private hospitals are allowed a semiannual refund of State and local sales and use taxes paid. For-profit hospitals are allowed a semiannual refund of State and local sales and use taxes paid on medicines and drugs. However, neither of these two refund provisions are applicable to hospitals owned or controlled by a governmental unit.

Under current law, local government agencies receive an annual refund of State and local sales taxes they pay but State agencies do not receive refunds of either State or local sales taxes. Local sales taxes paid by State agencies, including State-operated hospitals, are refunded quarterly to the General Fund rather than to the agency. State agencies do not receive refunds of State sales taxes because the appropriation of State funds for that agency includes the amount of sales tax payable by the agency.

As of the effective date of this act, the local sales taxes paid by the UNC hospitals will no longer be refunded to the General Fund and the State sales taxes paid by the UNC hospitals will no longer remain in the General Fund. These amounts will instead be paid directly to the UNC hospitals. Presumably, the appropriation to the UNC hospitals will be reduced to reflect this new refund.

This provision departs from the traditional policy that State sales taxes are not refunded to State-funded agencies. Refunding State sales taxes to agencies funded from the General Fund merely creates a loop of unnecessary administrative costs and paperwork as funds are paid into the General Fund as sales taxes then refunded by the Department of Revenue out of the General Fund. In all other cases, the same result is reached without the paperwork by including in the agency's General Fund appropriation an amount to cover the sales taxes paid into the General Fund. The latter approach saves the Department of Revenue and the State agency the administrative costs associated with periodic refunds.

This refund applies only to the UNC hospitals and not to other State hospitals and similar facilities. As well as the UNC hospitals, the State operates four psychiatric hospitals: Dorothea Dix Hospital, Broughton Hospital, Cherry Hospital, and John Umstead Hospital. In addition, the State operates various Alcohol and Drug Treatment Centers and Mental Retardation Centers around the State. These centers are in-patient facilities similar to hospitals. In the case of all State-operated hospitals and treatment centers other than the UNC hospitals, the General Assembly appropriates money from the General Fund to pay for sales taxes, rather than reducing the institution's appropriation and requiring the institution and the Department of Revenue to process refunds.

Lastly, the act makes permanent a quarterly distribution of a portion of the excise tax on wine to the North Carolina Grape Growers Council. Under G.S. 105-113.81A, 94% of the net proceeds of the excise tax collected on unfortified wine bottled in North Carolina during the previous quarter and 95% of the net proceeds of the excise tax collected on fortified wine bottled in North Carolina during the previous quarter is credited to the Department of Agriculture. The amount credited may not exceed $90,000 per fiscal year; any funds credited to the Department under this statute that are not expended during the fiscal year do not revert to the General Fund at the end of a fiscal year. The Department of Agriculture allocates these funds to the North Carolina Grape Growers Council to be used to promote the North Carolina grape and wine industry and to contract for research and development services to improve viticultural and enological practices in North Carolina.

This distribution has been in effect since 1987. Under the original legislation, the distribution would have terminated on June 30, 1997, and the funds would have been credited to the General Fund. This part of the act removes the sunset.

In 1973, the General Assembly enacted legislation providing that the tax on wine manufactured in North Carolina would be lower than the tax on other wines. In 1984, the United States Supreme Court decided in the Bacchus case that an unequal tax between in-state and out-of-state wine violated the Commerce Clause of the United States Constitution. As a result of this decision, the State and the local governments, who receive a percentage of the excise tax on wine, realized a revenue increase. In 1987, the General Assembly decided that a portion of this increased revenue should be used to promote and improve the State's grape and wine industry. This part of the act continues this philosophy.

In 1985, the General Assembly enacted an income tax credit for distributing North Carolina wine. Chapter 14 of the 1996 Second Extra Session repealed this credit because it had the same flaw as the intangibles tax stock deduction that was declared unconstitutional by the United States Supreme Court in the Fulton decision. The United States Supreme Court ruled that the intangibles tax stock deduction violated the interstate commerce clause of the federal constitution.

Chapter 19, 1996 Second Extra Session (House Bill 30, Representative Grady)

AN ACT TO REFUND TO FEDERAL RETIREES THE UNCONSTITUTIONAL TAXES THEY PAID ON THEIR PENSIONS FOR TAX YEARS 1985 THROUGH 1988.

This act gives federal retirees income tax credits and partial refunds for the North Carolina income taxes they paid on their federal retirement benefits in 1985, 1986, 1987, and 1988. These credits and refunds will cost the General Fund more than $117 million over three years. The amount a federal retiree may claim as a credit or refund is reduced by any amounts previously credited or refunded to the federal retiree for the same pension taxes. If a federal

retiree paid the 1985-88 pension taxes under timely protest, the retiree already received a refund as required by existing law. Under this act, federal retirees who did not make a timely protest and who pay North Carolina income tax may take a State income tax credit in three equal installments beginning with the 1996 tax year. For a taxpayer whose 1996 tax liability is less than 5% of the tax the taxpayer paid on federal retirement benefits during 1985-88, a one-time refund is allowed in lieu of a credit. The taxpayer must claim this refund by April 1, 1997. The refund allowed is the lesser of 85% of the amount claimed or a reduced amount. The reduced amount occurs when the total refunds claimed exceed the $25 million the General Assembly has set aside to pay for the refunds. If the $25 million cap is reached, then the refunds are prorated based on the amount each taxpayer claimed. If a federal retiree who would otherwise be eligible for a credit or refund has died, the retiree's estate may claim the credit or refund.

In 1990, the General Assembly gave to federal retirees who had not made a timely protest an income tax credit for the amount of tax paid on their federal retirement benefits in 1988. This tax credit was not refundable and was not allowed to deceased federal retirees; it was allowed in three installments. This credit was granted as a result of the 1989 United States Supreme Court decision in Davis v. Michigan, which held that the doctrine of intergovernmental tax immunity prohibits a state from taxing federal retirement income at a higher rate than State retirement income. Prior to 1989, North Carolina allowed a full income tax exclusion for State retirement income and a $3,000 annual exclusion for federal retirement income; there was no exclusion for private pension income. To comply with the Davis decision, the General Assembly in 1989 allowed all government retirees (state, local, and federal) a $4,000 annual exclusion. At the same time, it allowed private retirees a $2,000 annual exclusion.

The tax credit for 1988 taxes was enacted in 1990 to equalize the treatment of those who paid under protest for 1988 and those who did not. The Davis decision was issued on March 28, 1989, the middle of the income tax filing period for the 1988 tax year. Those taxpayers who learned about the Davis decision in time paid under protest within the 30-day time limit prescribed by law or refused to pay tax on their federal retirement benefits. Those who had paid their taxes early or did not become aware of the Davis decision until later were not able to make a timely protest.

The State currently faces similar constitutional challenges to several of its other taxes. The United States Supreme Court declared North Carolina's intangibles tax on stocks unconstitutional in the 1996 Fulton decision. Other taxes that were collected until their repeal in the 1996 tax year, such as the individual income tax credit for North Carolina dividends and the corporate income tax deduction for North Carolina dividends, have been identified by the Revenue Laws Study Committee as having the same constitutional flaw as the intangibles tax. Furthermore, State, local, and federal retirees are currently challenging the constitutionality of the income tax levied on their pensions for the tax years from 1989 to the present. Taxpayers who paid the intangibles tax and other unconstitutional taxes without filing a timely protest will likely seek legislation granting them refunds of three years' back taxes, relief similar to that granted federal retirees by this act. The cost of granting relief to other taxpayers in the same position as the federal retirees aided by this act could cost the General Fund hundreds of millions of dollars.

1996 Regular Session

1996 Chapter 560 (House Bill 1119, Rep. Shaw)

AN ACT TO DELETE THE REQUIREMENT THAT A COMPANY ADD BACK TO ITS NET WORTH FRANCHISE TAX BASE THE AMOUNT OF ITS LOANS THAT ARE PAYABLE TO AN UNRELATED COMPANY BUT ARE ENDORSED OR GUARANTEED BY A RELATED COMPANY, AS RECOMMENDED BY THE DEPARTMENT OF REVENUE.

This act deletes a provision in the corporate franchise tax laws that requires a parent, a subsidiary, or an affiliate of another corporation to include in its franchise tax base the amount of any debt that is owed by the corporation and is endorsed or guaranteed by one of its related corporations. The change is effective for taxable years beginning on or after October 1, 1996. The change is made at the recommendation of the Department of Revenue and is expected to have a revenue loss of no more than $10,000 a year.

Under current law, a corporation that is a parent, a subsidiary, or an affiliate of another corporation is required to add back to its net worth franchise tax base the amount of any debt it has that is payable to its parent, affiliate, or subsidiary or is endorsed or guaranteed by its parent, affiliate, or subsidiary. Debt that is not payable to a parent, affiliate, or subsidiary and is not guaranteed by one of these corporations is not required to be added back to the base. The act deletes the requirement that debt endorsed or guaranteed by a related company be added back and retains the requirement that debt payable to a related company be added back.

The Department of Revenue recommended this change because of the difficulty of enforcing the endorsement provision and the lack of need for the requirement. The existence of endorsed or guaranteed debt is often not readily ascertainable from the financial statements of a corporation. When a corporation endorses or guarantees a debt, it makes no accounting entry, such as the creation of a liability, to acknowledge the endorsement or guarantee. If the amount of debt endorsed or guaranteed is significant, the existence of the debt will be reflected in a footnote of the financial statements.

The franchise tax is a tax on corporations for the right or privilege to exist as a corporate entity and, in the case of foreign corporations, the right or privilege to do business in a corporate capacity in North Carolina. The tax is levied on the assets of a corporation. The tax rate is $1.50 per $1,000 with a minimum of $35. The franchise tax base on which the tax is computed is the largest of the following:

1. Capital stock, surplus, and undivided profits.
2. 55% of appraised property tax value of all taxable tangible property in North Carolina plus all taxable intangible property.
3. The corporation's actual investment in tangible property in North Carolina.

The add-back requirement is imposed to prevent related companies from understating their net worth through means of transactions with each other. A corporation can make capital available to another corporation in several ways. For example, it can buy the corporation's stock or loan the corporation money. The stock purchase would be reflected in the net worth of the company but the debt would be a deduction in computing net worth. To establish the economic reality between the companies, the loan is required to be added back so that it is in effect treated the same as the stock purchase.

Under current law, endorsed or guaranteed debt is required to be added back also even though the corporation making the endorsement or guarantee did not decrease its capital to increase that of the corporation receiving the loan. Endorsed or guaranteed debt is more like third-party debt than a loan from one company to another.

A recommendation of the Revenue Laws Study Committee.

1996 Chapter 590 (House Bill 540, Rep. Connie Wilson)

AN ACT TO AUTHORIZE THE ISSUANCE OF NINE HUNDRED FIFTY MILLION DOLLARS GENERAL OBLIGATION BONDS OF THE STATE, SUBJECT TO A VOTE OF THE QUALIFIED VOTERS OF THE STATE, FOR THE CONSTRUCTION OF HIGHWAYS AND TO AMEND THE HIGHWAY TRUST FUND.

This act authorizes the issuance of $950 million of highway bonds if approved by the voters in November 1996. Of the $950 million, $500 million is for the urban loop projects of the Highway Trust Fund, $300 million is for the Intrastate System projects, and $150 million is for paving secondary roads in the State highway system. The bonds would be repaid from Highway Trust Fund revenue allocated for the Trust Fund urban loops, the Intrastate system, and secondary road construction. The State last issued highway bonds in 1977; the amount of the bonds was $300 million. These bonds have been refinanced since 1977 but will be repaid at the end of 1997.

The bonds authorized by the act are State general obligation bonds. The State therefore pledges its taxing power to repay the bonds. The bonds must mature no later than December 1, 2013, the projected date for completion of all the Highway Trust Fund projects.

If issued, the revenue from the bonds would be appropriated to the Department of Transportation. $500 million would be used for urban loops around the following seven cities: Asheville, Charlotte, Durham, Greensboro, Raleigh, Wilmington, and Winston-Salem. $300 million would be used for the Intrastate System projects listed in G.S. 136-179. The remaining $150 million would be used to pave unpaved secondary roads on the basis of percentage of unpaved miles.

Revenue in the Highway Trust Fund is allocated as follows: 61.95% for Intrastate System Projects (these 32 projects are listed in the statutes); 25.05% for the seven designated urban loops; 6.5% for city streets; and 6.5%, plus $15.00 of the $35 title fee, for secondary roads. The $500 million in bonds for urban loops would be repaid from the 25.05% allocation for urban loops, the $300 million for Intrastate System projects would be repaid from the 61.95% allocation for these projects, and the $100 million in bonds for secondary roads would be repaid from the 6.5% allocation for secondary roads.

Additional funds could be applied to the Trust Fund urban loops without issuing bonds. Since the Trust Fund was established in October of 1989, the Department of Transportation has transferred $862.9 million from the Trust Fund to the Highway Fund for use on non-Trust Fund projects. This figure is 66.6% of the $1.29 billion Trust Fund revenue collected. If more revenue is applied to Trust Fund projects, less revenue would be applied to non-Trust Fund projects in the Transportation Improvement Program.

The Department of Transportation is almost exactly on schedule with the paving of secondary roads under the Trust Fund plan. Secondary roads are funded from both the Highway Fund and the Highway Trust Fund. An amount equal to 1 3/4 ¢ of the motor fuel tax is allocated for secondary roads from the Highway Fund and is distributed on the basis of the percentage

of unpaved secondary roads in each county. Of the Trust Fund supplement, $68,670,000 is allocated annually on the basis of vehicular traffic and the rest on the percentage of unpaved secondary roads.

1996 Chapter 631 (House Bill 1100, Rep. Daughtry)

AN ACT TO IMPLEMENT THE RECOMMENDATION OF THE SCHOOL CAPITAL CONSTRUCTION STUDY COMMISSION TO AUTHORIZE THE ISSUANCE OF GENERAL OBLIGATION BONDS OF THE STATE, SUBJECT TO A VOTE OF THE QUALIFIED VOTERS OF THE STATE, TO PROVIDE FUNDS FOR GRANTS TO COUNTIES FOR PUBLIC SCHOOL CAPITAL OUTLAY PROJECTS, IN ORDER TO PROMOTE EQUITY IN LOCAL SCHOOL FACILITIES ACROSS THE STATE AND TO ENABLE LOCAL GOVERNMENTS TO GIVE LOCAL PROPERTY TAX RELIEF, AND TO ENSURE THAT CERTAIN GRANTS FOR SCHOOL FACILITY NEEDS CONTINUE TO BE MADE IN ACCORDANCE WITH THE 1988 PRIORITY LIST.

This act authorizes the issuance of $1.8 billion of State public school bonds if approved by the voters in November 1996. It addresses the $6.2 billion backlog of school capital needs in this State that were identified by a needs assessment prepared for the General Assembly's School Capital Construction Study Commission. Of the $1.8 billion in bond proceeds, $30 million would be set aside for grants to small county school systems and the remaining $1.77 billion would be allocated on the basis of three different methods: 40% would be allocated to counties on the basis of average daily membership; 35% would be allocated on the basis of low wealth; and 25% would be allocated on the basis of high growth.

The State Board of Education would determine which of the small county school systems could receive a grant from the $30 million set aside for small school systems. A small county school system is one that was entitled to receive small school system supplemental funding under section 17.2 of Chapter 507 of the 1995 Session Laws, The Expansion and Capital Improvements Act of 1995. A county that receives a grant from the $30 million set aside does not have to match the allocation.

Counties would be required to match the allocations from the remaining $1.77 billion of bond revenue. The amount of the match is based on average daily membership and high growth. The required match is 3¢ times the county's 1995-96 ability to pay rank for each $1.00 of bond proceeds to be received under those allocations. This rank has been determined by the State Board of Education. Public school capital expenditures and the face amount of debt authorized or incurred for public school capital purposes since January 1, 1992, qualify for the match. With respect to debt authorized or incurred for public school facilities before January 1, 1992, amounts expended on or after January 1, 1992, for debt service for the debt qualify for the match. Any allocated funds that are not matched as required by January 1, 2003, will be redistributed among the counties that met the matching requirements.

The proceeds of the bonds must be used to construct or improve public school buildings, buy equipment needed for the newly constructed or improved school buildings, or buy land needed for the construction or improvement of the school buildings The facilitates financed by the proceeds must be used for instructional and related purposes and cannot be used for centralized administration facilities, maintenance facilities, trailers, relocatable classrooms, or mobile classrooms.

The bonds authorized by the act are State general obligation bonds. This means that the State pledges its taxing power in payment of the bonds. If issued, the debt service on the bonds would be one of the items to be paid by the State from its general revenues. The act

prohibits the State Treasurer from issuing more than $450 million of the bonds in any twelve-month period. The debt service costs of State general obligation bonds, including the $1.8 billion of school bonds proposed by this act, will be less than 2.5% of General Fund revenues. The debt service payments incurred due to the issuance of bonds or notes under this act are removed from any applicable General Fund spending limit.

The act also dissolves The Commission on School Facility Needs, specifies that the last 11 local school administrative units on the priority list established in 1988 by the Commission shall be funded from the Critical School Facility Needs Fund, and repeals the Fund 30 days after the last of those 11 projects are funded.

A recommendation of the School Capital Construction Study Committee.

1996 Chapter 646 (Senate Bill 1178, Sen. Cochrane)

AN ACT TO MAKE TECHNICAL AND CONFORMING CHANGES TO THE REVENUE LAWS AND RELATED STATUTES AND TO ALLOW THE VOLUNTARY WITHHOLDING OF INCOME TAX FROM UNEMPLOYMENT COMPENSATION PAYMENTS.

This act makes numerous technical and clarifying changes to the revenue laws and related statutes. It also amends North Carolina's unemployment compensation law to allow the voluntary deducting and withholding of federal and State income taxes in accordance with federal law. The following table provides a section-by-section analysis of the proposed changes.

Section	Explanation
1.	Adds a caption to this subsection. The other subsections of this statute all have captions.
2.	Returns to the statute words that were inadvertently deleted in 1995.
3.	Repeals two obsolete statutes, imposing franchise taxes on pullman, sleeping, chair, and dining cars, and on express companies. Railroads pay general franchise and income taxes. There are no longer any express companies; if there were, they would pay the general franchise and income taxes.
4.	Returns the term "held" to the statute. In 1995, this sales tax exemption was revised to clarify that aquaculture is covered. The statute applies to animals or plants produced <u>or held</u> for commercial purposes; the 1995 rewrite accidentally removed "held".
5.	Repeals a provision that grants a sales tax exemption for works of art purchased pursuant to the art in State buildings program of Article 47A of Chapter 143B of the General Statutes. Because that program has been repealed, the sales tax exemption is no longer needed.
6.	Corrects an incorrect citation.
7-8.	Repeals obsolete administrative provisions in the gift tax provisions. These provisions have been superseded by Article 9 of Chapter 105 of the General Statutes. Article 9 of Chapter 105 contains the administrative provisions that apply to all taxes administered by the Secretary under that Chapter.

9. Repeals the penalty of $10 a day for failure to file a privilege license tax return or franchise tax return, which is obsolete and redundant. The general penalties that apply to all taxes already apply to these taxes.

10. Allows the Secretary of Revenue to assess a negligence penalty for reporting improper adjustments to federal taxable income to the same extent as for understating gross income or overstating deductions. In cases of substantial income tax deficiencies, a 25% penalty is assessed if the deficiency was caused by understating gross income or by overstating deductions, both of which are determined on the federal return. The penalty provisions do not address deficiencies caused by improper adjustments to federal taxable income: adjustments that are made at the State level to determine North Carolina taxable income. This section provides that the same penalty applies whether the deficiency resulted from understating gross income, overstating deductions, or misstating adjustments. This section also repeals references to "this subchapter," which are obsolete. The term "tax" is now defined to include not only taxes under Subchapter I of Chapter 105 of the General Statutes but also taxes under Subchapters V and VIII and inspection taxes levied under Article 3 of Chapter 119 of the General Statutes. Finally, this section corrects spelling errors and modernizes the language of the statute.

11. Reinstates an extended period of time for making assessments for income tax due attributable to gains from involuntary conversions or from the sale of a principal residence parallel to federal law. The extension is necessary because the law allows the taxpayer a period of time to replace the converted property or the principal residence with similar property and thereby avoid recognition of the gain. If the taxpayer fails to replace the property, gain is recognized and the assessment may be made within three years after the Secretary is notified that the requirements for nonrecognition will not be met. Before 1989, North Carolina's individual income tax contained a similar provision; when the tax law was rewritten to "piggyback" the federal internal revenue code, that provision was inadvertently not picked up.

12. Corrects a citation. The federal statute to which this language refers has been renumbered.

13-14. Effective July 1, 1996, revises the split inventory tax reimbursement date from an August/April date to a September/April date and changes the 60%/40% split to a 50%/50% split. 1995-96 will be the only year in which the 60/40 August/April split reimbursement occurred. Because these sections become effective July 1, 1996, changing the 1995 languages does not affect the validity of what is being done in 1995-96.

15. Corrects an incorrect cross-reference.

16. Exempts certain property owners from filing annual applications for property tax exemptions. According to the Institute of Government, by administrative practice, annual applications are not required for exempt property of veterans' organizations, Masonic lodges and shrines, elks and similar fraternal organizations, or disabled veterans. In addition, the Institute of Government suggests that there is no reason to require annual applications for exemption of pollution control and recycling equipment because the exemption is automatic

once the Department of Environment, Health, and Natural Resources determines that the equipment qualifies.

17. Corrects an inadvertent expansion of the use value law. Legislation enacted in 1995 codified existing interpretations of the use value law that allow a partner in a partnership or a member of a limited liability company to treat their share of land owned by the entity as if they owned it directly. The legislation inadvertently included corporate-owned land under the same rule.

18. Removes redundant language that renders certain definitions circular. This section also modernizes the form in which the definitions are set out.

19. Restores omitted reference. Until 1995, funds in the Insurance Regulatory Fund could be used only to reimburse the General Fund for the Department of Insurance's expenses in regulating the insurance industry and other industries in this State. The statute was expanded in 1995 to include expenses of other State agencies in regulating the insurance industry and in carrying out certain duties under the Medical Care Data Act. The 1995 rewrite inadvertently omitted reference to other industries, in addition to insurance, that the Department of Insurance regulates. For example, the Department regulates bail bondsmen and collection agencies.

20. Removes an unnecessary reference to an effective date.

21. Existing law provides that certain local tax records are not public records; this section clarifies the corresponding provision under the Public Records Act.

22. Relocates a provision in the consolidated city-county act to the appropriate statute. The provision applies to all urban service districts but is currently located in a statute that applies only to certain urban service districts. A consolidated city-county is a county in which the largest municipality has been abolished and its powers, duties, rights, privileges, and immunities have been consolidated with those of the county. Other municipalities may also be abolished and consolidated with the county. A consolidated city-county may define urban service districts to finance services within the county at a higher level than in other areas of the county. These urban service districts may replace municipalities that have been abolished or may be created to serve areas that have population density, property valuation, and needs that justify a higher level of services than is provided in the county generally.

23. Amends existing local acts establishing beautification districts to clarify that the districts are special districts established under Article VII of the North Carolina Constitution and not special tax areas governed by Section 2(4) of Article V of the North Carolina Constitution. The constitution permits local acts establishing special tax districts but not local acts establishing special tax areas. The following local acts authorize beautification districts:

    1. Dare County, Duck District: SL83-991, SL93-610, and SL95-303.
    2. Dare County, Outer Banks District: SL89-363.
    3. Currituck County, Currituck Outer Banks District: SL89-400 and SL95-446. The former citation appears to be obsolete.
    4. Currituck County, Coinjock Canals District: SL89-703.
    5. Cabarrus County, Poplar Tent: SL91-685.

24. Clarifies the valuation date to be used for vehicles registered for property taxes under the annual system. In 1995, the General Assembly amended the law concerning the valuation of motor vehicles to eliminate the problem of the correct valuation date when an owner with a registration that expires December 31 renews during the January grace period. In eliminating the problem for vehicles registered on a staggered system, the amendment created a problem for those registered on an annual system. In the latter case, it may result in the same valuation being used for two years. This act corrects this problem.

25. Amends North Carolina's unemployment compensation law to allow the voluntary deducting and withholding of federal and State income taxes in accordance with federal law. If an individual elects to have federal income tax withheld, then 15% of the payment will be withheld for federal income tax purposes. Fifteen percent is the lowest tax bracket at the federal level. If an individual elects to have State income tax withheld, then the individual may determine the amount to be withheld. This provision follows the general rule for voluntary withholdings of State individual income tax in G.S. 105-163.3(g). Although unemployment compensation has always been subject to income tax, the deducting and withholding of income tax from unemployment compensation payments has not been allowed because of the restrictive nature of the Unemployment Trust Fund. Congress enacted legislation to allow voluntary deducting and withholding of federal and state income taxes from the payments, effective for payments made on or after January 1, 1997.

26. Effective date.

1996 Chapter 647 (Senate Bill 1198, Sen. Kerr)

AN ACT TO CLARIFY THE REQUIREMENTS CONCERNING IMPORTS AND EXPORTS OF MOTOR FUEL UNDER THE "TAX AT THE RACK" LAWS AND TO MAKE OTHER ADJUSTMENTS TO THOSE LAWS.

This act adjusts the motor fuel tax collection system, known as "tax at the rack," that was enacted by the General Assembly in the 1995 Session and became effective January 1, 1996. To date, the 1995 legislation has increased motor fuel tax revenues as predicted. If collections continue at the same level for the remainder of the year, motor fuel tax revenue will increase by about $27 million dollars. The changes made by this act primarily clarify the tax treatment of exports, imports, blended fuel, and the inspection tax on kerosene and fill in gaps discovered in implementing the new law.

Imports: The act makes it clear that a separate importer license is not required if a person is licensed as a distributor and buys motor fuel for import only from an out-of-state supplier that collects the North Carolina tax. These tax-collecting suppliers are known as elective or permissive suppliers. Current law appears to require all importers to have an importer license regardless of other licenses they may have. The act also makes it clear that an importer that buys from an elective or permissive supplier is entitled to the same discount and "float" as if the fuel had been purchased inside the State.

Exports: The act makes it clear that an exporter is not required to have a license and treats licensed exporters differently than unlicensed exporters. An unlicensed exporter must pay tax to North Carolina at the North Carolina rate of tax and then apply for a refund when the

fuel is resold out-of-state. A licensed exporter can pay tax at the rate of the destination state of the fuel, thereby eliminating the need for a refund. If exported fuel is to be sold for an exempt use in the destination state, the licensed exporter can buy the fuel tax-free until July 1, 1997, when this privilege sunsets.

Blended Fuel: The act makes it clear that the tax due on fuel-grade ethanol is payable by the supplier of that fuel rather than by the person who buys it and makes the blend of ethanol and gasoline. This ensures that the tax is collected at the highest point in the distribution chain and parallels the collection of the tax on gasoline. The act also requires a blender to post a bond if the blender's average expected annual tax liability is at least $2,000. Prior law required a bond from blenders, so this change reinstates the requirement in a modified form.

Kerosene Inspection Tax: The act sets the due date for payment of the kerosene inspection tax at the date set for payment of motor fuel taxes and eliminates the need for most kerosene distributors to be licensed. It eliminates the need for a license for those distributors that buy kerosene only from in-State suppliers or from elective or permissive out-of-State suppliers. The license is not needed because the kerosene inspection tax is collected by suppliers at the rack along with the motor fuel tax. A kerosene distributor can choose to be licensed and get the payment deferral and float. The only kerosene distributors that must continue to be licensed are airlines that have spur pipelines for kerosene.

Other Changes: The act makes several other changes to the penalty and reporting provisions and adds a tax on unauthorized behind-the-rack transfers to parallel federal law. The penalty changes impose liability on a person who accepts delivery of motor fuel when the shipping document for the fuel shows a different destination state for the fuel. It adds as a Class 1 misdemeanor the failure of a supplier to give a distributor the deferred payment and float. It adds a civil penalty for refusing to allow a sample of motor fuel to be taken, for a terminal operator that has unaccounted for motor fuel losses, and for failure to file a motor fuel informational return.

A recommendation of the Revenue Laws Study Committee.

1996 Chapter 649 (Senate Bill 1239, Sen. Cooper)

AN ACT TO EXEMPT FROM SALES AND USE TAX FREE SAMPLES OF PRESCRIPTION DRUGS DISTRIBUTED BY THE MANUFACTURER.

This act creates a new sales and use tax exemption for prescription drugs that are distributed free of charge by the manufacturer. The sale of drugs bought with a prescription has been exempt from sales tax since 1937. The act defines the term "prescription drug" to be a drug that under federal law is required, prior to being dispensed or delivered, to be labeled with the following statement: "Caution: Federal law prohibits dispensing without prescription." This is the same definition used for the term in the Pharmacy Practice Act, G.S. 90-85.3. The act became effective upon ratification, June 21, 1996. The revenue loss to the General Fund is expected to be less than $400,000 a year.

Pharmaceutical companies often distribute free samples of prescription drugs to physicians to give to their patients. The prescription drugs that are distributed by free samples to the physicians are generally prescribed by them to their patients. Although the prescribed drugs are exempt from sales tax, the Department of Revenue has assessed use tax on the free samples. The use tax, first enacted in 1939, is the complement of the State's sales tax and is imposed on the storage, use, or consumption in this State of tangible personal property. A

pharmaceutical manufacturer is not liable for sales or use taxes when it purchases the ingredients used to manufacture the prescription drugs because the products are to be resold. However, when the manufacturer chooses to give the drug samples away rather than sell them, the Department has held the manufacturer liable for the use tax on the drugs.

Last year, Abana Pharmaceuticals, Inc. appealed an assessment of use tax on free samples of prescription drugs distributed to North Carolina physicians. The Tax Review Board reversed the decision of the Assistant Secretary for Legal and Administrative Services and concluded, based on the sales tax exemption for prescription drugs, that the free samples of prescription drugs distributed to physicians are exempt from use tax. The Department is appealing the Tax Review Board's decision. This act exempts the free samples from use tax prospectively. If the Court upholds the Board's decision, then the exemption will apply retroactively to Abana Pharmaceuticals, Inc., and arguably to all other similarly situated pharmaceutical companies.

The free distribution of prescription drugs by physicians is not subject to tax because the taxable use of the samples occurred prior to their distribution by the physician when the manufacturer provided the drugs to its salespersons. Hospitals and other purchasers of drugs without a prescription will still be subject to the sales and use tax. Nonprofit hospitals are entitled to a refund of any sales and use taxes paid under G.S. 105-164.14(b).

1996 Chapter 664 (House Bill 1147; Rep. Shubert)

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

This act rewrites the definition of the Internal Revenue Code used in State tax statutes to change the reference date from January 1, 1995, to March 20, 1996. This change makes Code changes made during this period effective for any State taxes that are tied to the affected parts of the Code. The impact on the General Fund is expected to be insignificant.

Only four changes were made in the Code from January 1, 1995, until March 20, 1996. The first three of these were made in The Self-Employed Health Insurance Act (Public Law 104-7 (H.R. 831), enacted in 1995, and the last one was part of legislation enacted on March 20, 1996:

1. The individual income tax deduction for health insurance premiums paid by self-employed individuals was reinstated and made permanent. This includes premiums paid on behalf of the self-employed individual, a spouse, and dependents. The deduction is 30% of the qualifying premiums.
2. Code section 1033 was amended to make C corporations and certain partnerships ineligible to defer gain on an involuntary conversion under that section when replacement property is purchased from a related person. The change was effective for acquisitions after February 5, 1995.
3. Code section 1071 was repealed effective for sales or exchanges after January 16, 1995. That section allowed a taxpayer to treat the sale of a broadcast property as an involuntary conversion if the sale was certified by the FCC as necessary to effectuate an FCC ownership and control policy.
4. The Code was amended to increase the amount of military pay that is exempt from income tax for certain commissioned officers serving in the peacekeeping efforts in

Bosnia and Herzegovina, known as Operation Joint Endeavor, and to exclude exempt military pay from withholding requirements.

Since the State corporate income tax was changed to a percentage of federal taxable income in 1967, the reference date to the Internal Revenue Code has been updated periodically. In discussing bills to update the Code reference, the question frequently arises as to why the statutes refer to the Code as it existed on a particular date instead of referring to the Code and any future amendments to it, thereby eliminating the necessity of bills like this. The answer to the question lies in both a policy decision and a potential legal restraint.

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

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

A recommendation of the Revenue Laws Study Committee.

1996 Chapter 691 (Senate Bill 1179, Sen. Kerr)

AN ACT TO PROVIDE A GRACE PERIOD FOR MILITARY PERSONNEL TO LIST AND PAY PROPERTY TAXES AFTER DEPLOYMENT IN CONNECTION WITH OPERATION JOINT ENDEAVOR.

This act gives military personnel deployed in the peacekeeping effort in Bosnia and Herzegovina, known as Operation Joint Endeavor, 90 days after the end of their deployment to pay their 1995-96 or later property taxes without interest and to list property for the 1996-97 tax year or a later tax year. The act applies to those serving in or in support of the armed forces and armed forces reserves, including the national guard. Deployment of military personnel pursuant to Operation Joint Endeavor began December 4, 1995. Approximately two-thirds of the 25,000 military personnel deployed in Operation Joint Endeavor are from North Carolina bases.

Property taxes for the 1995-96 fiscal year would otherwise become delinquent if not paid by January 6, 1996, and interest would accrue at the rate of 2% for the first month and 3/4% each month thereafter. The regular listing period for property taxes for the 1996-97 year ended on January 31, 1996. Failure to list is punishable as a misdemeanor and also subjects the owner of the property to a tax penalty equal to 10% of the tax due on the property. Automobiles are taxed on a staggered, year-round schedule, so the listing date and the date the taxes become delinquent may fall at any time during the year.

The act is effective retroactively as of December 4, 1995. Any interest and penalties assessed before it is enacted would be refunded.

G.S. 105-249.2 and G.S. 105-158 already provide income tax extensions for military personnel serving in a combat zone and income tax forgiveness for personnel who are killed while serving in a combat zone, to the same extent as federal law (sections 7508 and 692 of the Internal Revenue Code). Our Department of Revenue will automatically follow the federal law. Congress has enacted Public Law 104-117 providing that these sections of the Code apply to personnel deployed in connection with Operation Joint Endeavor.

A recommendation of the Revenue Laws Study Committee.

1996 Chapter 696 (House Bill 1094, Rep. Cansler)

AN ACT TO PROHIBIT THE IMPOSITION OF A FAILURE TO PAY PENALTY WHEN ADDITIONAL TAX DUE IS PAID AT THE TIME AN AMENDED RETURN IS FILED OR WITHIN THIRTY DAYS AFTER THE ADDITIONAL TAX WAS ASSESSED.

This act prohibits the imposition of a tax penalty for failure to pay in two circumstances. The first circumstance is when an additional tax is due with an amended return. The second circumstance is when a tax assessed by the Secretary of Revenue is paid within 30 days after it was assessed. The changes become effective for taxes due on or after January 1, 1997. The act should decrease General Fund revenues by no more than $100,000 a year.

The failure to pay penalty is 10% of the amount due, with a minimum penalty of $5.00. The Secretary of Revenue has the authority under G.S. 105-237 to waive the penalty. The decision of whether or not to waive a penalty is made on a case by case basis.

Currently, G.S. 105-236(4) requires the failure to pay penalty to be assessed whenever a tax is not paid when it was due. The due date for additional tax owed on an amended return is considered to be the date the original return was due. Consequently, any time a taxpayer files an amended return and pays additional tax with the return, the taxpayer is assessed the failure to pay penalty. Similarly, the due date for a tax assessed by the Secretary is considered to be the date the tax should have been paid without resort to an assessment. Consequently, any time a taxpayer is assessed for unpaid taxes, the taxpayer is also assessed the failure to pay penalty.

The changes made by this act make the "trigger" for the State failure to pay penalty the same as under federal law. A federal failure to pay penalty is not assessed when additional tax shown on an amended return is paid when the return is filed nor when a tax assessed by the Internal Revenue Service is paid within 10 days after the date on the notice of assessment and demand for payment. The penalty is not assessed under either federal or State law if a return is filed after an extension has been granted and the amount of tax paid when the extension was granted is at least 90% of the amount shown on the return.

In discussing this issue, the Revenue Laws Study Committee concluded that applying a failure to pay penalty to additional tax that is shown due on an amended return and is paid with the return discourages the filing of an amended return and does not make any allowance for reporting errors on tax reporting statements such as 1099 forms issued by banks and brokerage houses and W-2 forms issued by employers that result in the need for an amended return. The Committee further concluded that allowing a grace period after a tax is assessed before applying a failure to pay penalty would encourage prompt payment of the assessed taxes. Finally, the Committee concluded that applying a State failure to pay penalty in the

circumstances described when no federal penalty applies is unnecessarily confusing and makes the State law on this topic harsher than the federal.

A recommendation of the Revenue Laws Study Committee.

1996 Chapter 741 (Senate Bill 1165, Sen. Kerr)

AN ACT TO ALLOW COUNTIES TO REMOVE VEHICLE REGISTRATION TAX BLOCK UPON FULL PAYMENT OF PROPERTY TAXES.

Since 1993, counties have collected property taxes on motor vehicles that are registered with the Division of Motor Vehicles on a revolving year-round basis. If the taxes are not paid within four months after the date they are due, the tax collector must send a list of the delinquent taxpayers and their vehicle identification number to the Division. The Division must refuse to renew the vehicle's registration until the taxpayer presents it with a paid tax receipt. This act will allow a county to remove the "block" when the delinquent taxes are paid, rather than require the taxpayer to present a paid tax receipt to the Division at the time the vehicle registration is renewed. To remove the "block", the county tax collector must certify to the Division that the delinquent taxes have been paid. The certification must be in the form and contain the information required by the Division.

This change was requested by the Division of Motor Vehicles. There are about four and one-half months between the time the "block" is electronically put on the vehicle's registration and the time the vehicle registration must be renewed. Taxpayers who pay the property tax within this window of time do not always remember to bring a paid tax receipt with them when they go to renew their vehicle registration. This situation upsets taxpayers who have paid their property taxes but cannot renew their vehicle registration until they find, or obtain a copy of, their paid tax receipt. This act will ease the burden on these taxpayers by allowing the county to remove the "block" at the time the tax is paid. The Division will decide what form the certification must take. The act does not require the counties to submit this certification to the Division because not all of the counties have the capacity to electronically communicate with the Division.

A recommendation of the Joint Transportation Oversight Study Committee.

1996 Chapter 747 (House Bill 1096, Rep. Cansler)

AN ACT TO TRANSFER RESPONSIBILITY FOR COLLECTING THE REMAINDER OF THE GROSS PREMIUMS TAX FROM THE DEPARTMENT OF INSURANCE TO THE DEPARTMENT OF REVENUE AND TO CLARIFY RELATED STATUTES.

This act completes a transfer of responsibility from the Insurance Department to the Department of Revenue that was begun in 1995. The transfer that is completed is the responsibility of collecting the various insurance gross premiums taxes. The act becomes effective January 1, 1997. The act also makes technical and clarifying changes to the affected statutes.

The insurance gross premiums taxes are taxes based on the amount of insurance premiums that are paid or, for certain self-insurers, would have been paid during the year. They consist of a 1.9% premiums tax on for-profit insurance companies, a 0.5% tax on nonprofit companies, such as Blue Cross/ Blue Shield and Delta Dental, that provide hospital, medical, and dental coverage, a 2.5% tax on workers' compensation premiums and workers' compensation self-insurers, a 1.33% additional fire and lightning tax on property premiums for

coverage of property other than motor vehicles and boats, and another 0.5% fire and lightning tax on all property premiums on business inside a municipality.

The 1995 General Assembly, in Chapter 360 of the 1995 Session Laws, transferred the responsibility of collecting the following gross premiums taxes from the Department of Insurance to the Department of Revenue: the general, for-profit 1.9% tax, the 2.5% tax on workers' compensation premiums but not on workers' compensation self-insurers, and the non-profit 0.5% tax. It did not transfer collection of the 2.5% tax on workers' compensation self-insurers or either of the additional fire and lightning taxes. This act transfers collection of those three taxes effective January 1, 1997. The Department of Revenue is already collecting the additional 1.33% fire and lightning tax pursuant to an agreement with the Department of Insurance.

A workers' compensation self-insurer is an employer that carries its own workers' compensation risk or pools its risk with other employers that belong to the same trade or professional association as the employer. The 2.25% gross premiums tax applies to the amount of premiums the employer would be charged if the employer acquired workers' compensation insurance from an insurance company. Two Department of Insurance employees currently administer collection of this tax based on payroll information supplied by employers. The act transfers one position from the Department of Insurance to the Department of Revenue.

Twenty-five percent of the additional 1.33% fire and lightning tax and all of the additional 0.5% fire and lightning tax are used for special purposes. The rest of the gross premiums taxes are credited to the General Fund. Twenty-five percent of the 1.33% fire and lightning tax is credited to the Volunteer Fire Department Fund in the Department of Insurance. The 0.5% fire and lightning tax is credited to the Department of Insurance and is disbursed to local fire fighters' relief funds.

This act does not affect the collection of three special taxes on insurance companies. The three taxes are: a tax on surplus lines insurance, a tax on risk retention by a company chartered in another state, and a tax on unlicensed insurers.

Surplus lines insurance is a market of last resort for commercial property and liability risks. The tax is collected not from insurance companies but from the brokers who place the coverage. The tax is based on information sent in by these brokers, who are called surplus lines licensees, and must be reconciled based on the surplus lines market and other technical factors. The tax is levied on a quarterly basis and is not similar in administration, calculation, or collection to the gross premiums tax.

For risk retention groups chartered in other states, there is a quarterly tax similar to the surplus lines tax. There are only about 35 risk retention groups chartered in other states; their total tax represents less than $250,000 a year. Existing law requires any State-chartered risk retention group to be licensed as an insurance company; it would, therefore, be covered by the general gross premiums tax collected by the Department of Revenue. In addition, insurers of purchasing groups already pay the gross premiums tax to the Department of Revenue like any other insurance company. If a purchasing group purchases coverage from a surplus lines insurer, however, the surplus lines tax applies to the premiums.

Unlicensed insurers are a special category of insurers, allowed to provide coverage only if the insured makes an affidavit that the insured could not obtain insurance from licensed insurers after diligent search. A detailed report and this affidavit must be filed by the person who procures the insurance within 30 days after the insurance is procured and the tax is due at that time. This tax is closely tied to regulation of the insurers and its collection is not similar to the gross premiums tax.

1996 First Extra Session

Chapter 1, 1996 First Extra Session (Senate Bill 2, Sen. Kerr)

AN ACT TO IMPLEMENT A ZERO UNEMPLOYMENT INSURANCE TAX RATE FOR 1996 FOR ALL EMPLOYERS WITH A POSITIVE EXPERIENCE RATING, ALLOW EMPLOYERS WITH A NEGATIVE RATING TO QUALIFY FOR THE ZERO RATE BY PREPAYING TAXES, REDUCE THE RATE FOR NEW EMPLOYERS FROM ONE AND EIGHT-TENTHS PERCENT TO ONE AND TWO-TENTHS PERCENT, ALLOW NEW EMPLOYERS TO QUALIFY SOONER FOR REDUCED RATES, AND AUTHORIZE A LEGISLATIVE RESEARCH COMMISSION STUDY.

This act continues the General Assembly's past efforts to reduce the amount of money in the Unemployment Insurance Fund and to avoid taxing for a surplus. The act reduces unemployment taxes in three ways and benefits almost every employer:

1. POSITIVE RATED EMPLOYERS. -- Assigns a <u>one-year</u> zero unemployment insurance tax rate for <u>all</u> positive rated employers. Approximately 115,000 employers have positive rated accounts. The tax reduction enacted in 1995 allowed approximately 15% of these employers to earn a zero tax rate. This act gives the remaining 85% of positive rated employers a zero tax rate for 1996, saving them $135 million. In the absence of any change in circumstances, an employer will resume paying unemployment taxes in 1997 at the same rate the employer would have paid taxes in 1996 if the act had not enacted.
2. NEGATIVE RATED EMPLOYERS. -- Gives overdrawn employers additional time to make contributions to their accounts so that they may qualify for the zero tax rate in 1996. An employer may make voluntary contributions in order to have a lower tax rate the following year. Generally, voluntary contributions must be made before July 31. It is estimated that 1/2 of the 7,000 employers with a negative rating may contribute $18 million and receive $41 million in tax relief, for a net savings of $23.5 million.
3. NEW EMPLOYERS. -- <u>Permanently</u> reduces the tax rate for new employers from 1.8% to 1.2%. Nationally, the most common tax rate for new employers is 2.7%. This act also reduces the period of time required for new employers to achieve lower rates from 3 years to 2 years. This would save an estimated 24,000 employers who are not rated $5 million for 1996. The rate was last reduced in 1994 from 2.25% to 1.8%.

The Employment Security Commission estimates that the unemployment tax reduction in this act will save employers between $140 million and $163.5 million for 1996. The act became effective January 1, 1996.

The act authorizes the Legislative Research Commission to study issues relating to the State's Employment Security Law. The Commission did not report to the 1996 Session of the General Assembly. The act directs the Commission to report to the 1997 General Assembly. The act also made a change in the State law so that it conforms with the federal law. Under State law, an employer could not move to a lower rate unless it had a chargeable account for more than 13 consecutive months immediately preceding the date for calculating the employer's tax rate. The act changed the requirement of "13 consecutive months" to "at least 12 calendar months". The latter requirement focuses attention on cumulative employment rather than

consecutive quarters. The change removed a technical barrier that would have kept a handful of employers from moving from the standard rate to a reduced rate.

The General Assembly cut the unemployment tax rate in 1993, 1994, and 1995. Despite these cuts, the North Carolina Trust Fund in Washington, from which unemployment benefits are paid, was slightly more than $1.5 billion. It is estimated that this act would reduce the State Unemployment Insurance Trust Fund balance from about $1.5 billion to $1.29 billion in 1996. Without the act, the Trust Fund balance was expected to be reduced to only $1.43 billion in 1996. The 1996 balance in the fund is far more than needed to meet the State's unemployment compensation obligations. North Carolina has the fifth highest Trust Fund balance of any state in the nation relative to the amount of benefits paid out of the Trust Fund in prior years.

In 1995, the General Assembly reduced unemployment insurance taxes by an average of 23% for rated employers with a positive credit balance, set a zero tax rate for employers with credit ratios of 5.0 or over, and reduced from 60% to 50% the percentage of annual average wages used to calculate the taxable wage base. In 1994, the General Assembly reduced unemployment insurance taxes by an average of 38% for rated employers with a positive credit balance and by 20% for employers who are not yet rated. In 1993, the General Assembly enacted legislation that reduced the unemployment insurance tax rate by 30% for rated employers with a credit balance in their unemployment insurance tax account for any calendar year in which the balance in the Unemployment Insurance Trust Fund equals or exceeds $800,000,000 as of the preceding August 1. The 1994 tax cut legislation increased this percentage reduction to 50%. In 1992, the General Assembly suspended an additional unemployment tax collected from employers and credited to the Employment Security Commission Reserve Fund, which bolsters the State Unemployment Insurance Trust Fund.

In 1994, the General Assembly also increased benefits payable to claimants by restoring the pre-1983 formulas for computing unemployment benefits. The North Carolina average weekly benefit amount paid to claimants for unemployment benefits is the highest in the southeast at $188.00. North Carolina also pays the highest maximum weekly benefit amount in the southeast at $297.00. Compared to the 11 largest states in the United States, North Carolina's average benefit ranks 7th and its maximum benefit ranks 4th.

Unemployment tax contributions are paid by employers on a quarterly basis and deposited into the State Unemployment Insurance Trust Fund. After deducting any refunds payable from the Fund pursuant to G.S. 96-10(f), the money is deposited with the secretary of the treasury of the United States to the credit of this State's account in the Unemployment Trust Fund. Funds in the State's account earn interest that is also credited to the account. As money in the State's account is needed to pay benefits, it is transferred to the State and credited to the benefits account of the State's Unemployment Insurance Fund to be used to pay benefits to people who lose their job through no fault of their own. Federal law prohibits transfer of or payment of refunds from money in the Trust Fund.

1995

Prepared by Cynthia Avrette, Sabra J. Faires, and Martha H. Harris

1995 Chapter 4 (Senate Bill 13, Sen. Kerr)

AN ACT TO FURTHER REDUCE EMPLOYERS' UNEMPLOYMENT INSURANCE TAXES.

This act reduces unemployment insurance taxes, effective January 1, 1995, in the following ways:

1. It lowers the taxable wage base for the tax by changing the formula used to compute the base. It reduces from 60% to 50% the percentage of annual average wages used to calculate the taxable wage base. This change reduces the 1995 wage base from 13,500 to 12,300. This tax reduction benefits all employers and will save existing employers as well as new businesses an estimated $36 to $40 million a year.
2. It reduces the tax rates that apply to rated employers with a positive unemployment insurance account balance. This reduction is estimated to save employers about $15 million a year.
3. It sets a zero tax rate for employers with credit ratios of 5.0 or over. Under current law, the lowest rate is 0.01%. This change is estimated to save employers about $130,000 a year.

Taken together, the changes cut unemployment insurance taxes by about 23% and save employers more than $51 million a year. Unemployment tax contributions are paid by employers on a quarterly basis and deposited into the State Unemployment Insurance Trust Fund. After deducting any refunds payable from the Fund pursuant to G.S. 96-10(f), the money is deposited with the secretary of the treasury of the United States to the credit of this State's account in the Unemployment Trust Fund. Funds in the State's account earn interest that is also credited to the account. As money in the State's account is needed to pay benefits, it is transferred to the State and credited to the benefits account of the State's Unemployment Insurance Fund to be used to pay benefits to people who lose their job through no fault of their own. Federal law prohibits transfer of or payment of refunds from money in the Trust Fund.

The General Assembly has reduced unemployment insurance taxes several times in recent years. In 1994, the General Assembly reduced the taxes by an average of 38% for rated employers with a positive credit balance and by 20% for employers who are not yet rated. A rated employer is an employer who has had a chargeable account for more than 13 consecutive months immediately preceding the date for calculating the employer's tax rate.

In 1993, the General Assembly enacted legislation that reduced the unemployment tax rate by 30% for rated employers with a credit balance in their unemployment insurance tax account for any calendar year in which the balance in the Unemployment Insurance Trust Fund equals or exceeds $800,000,000 as of the preceding August 1. This percentage reduction in the tax rate was increased to 50% in the 1994 legislation as part of the tax rate reduction for employers who have a credit balance in their unemployment insurance tax account. In 1992, the General Assembly suspended an additional unemployment tax collected from employers and credited to the Employment Security Commission Reserve Fund, which bolsters the State

Unemployment Insurance Trust Fund. Despite these cuts, the North Carolina Trust Fund in Washington, from which unemployment benefits are paid, is close to $1.5 billion.

Before enactment of the 1994 legislation, North Carolina's average unemployment tax rate, 0.5%, was already the 45th lowest in the nation. Since the enactment of the 1995 act, North Carolina's average unemployment tax rate is the lowest in the nation. The 1.8% starting rate for new employers is now the second lowest rate in the nation. The North Carolina average weekly benefit amount paid to claimants for unemployment benefits is the highest in the southeast at $171.41. North Carolina also pays the highest maximum weekly benefit amount in the southeast at $289.00.

1995 Chapter 7 (House Bill 80, Rep. Tallent)

AN ACT TO REPEAL THE SPECIAL USE TAX ON CONSTRUCTION EQUIPMENT BROUGHT INTO THE STATE.

This act repeals the special use tax that was levied in 1957 on vehicles, machinery, tools, and other equipment brought into North Carolina for use in construction. The repeal became effective July 1, 1995. This act was recommended by the Revenue Laws Study Committee. The Department of Revenue suggested this issue as a study topic for the committee because the tax generated little revenue, was difficult for taxpayers to understand and comply with, was difficult to administer, and no longer served its original purpose of protecting North Carolina contractors from out-of-state competition. The repeal is expected to result in a General Fund revenue loss of no more than $20,000 a year.

The special use tax applied to contractors who do work in more than one state, purchase equipment in a state other than North Carolina for use in the other state, and then bring the equipment to this State for use in construction. The regular sales and use tax would not apply to this equipment because the equipment was not purchased in this State and was not purchased for use in this State. The special use tax rate for an item other than a motor vehicle was the regular use tax rate of 4% State and 2% local. The special use tax rate on a motor vehicle was the same as the highway use tax rate, which is 3% subject to the applicable maximums.

To compute the special use tax due on an item of equipment, a contractor had to multiply the sales price of the equipment by the percentage of the equipment's useful life that was expected to be spent in North Carolina. The contractor then had to apply the applicable special use tax rate and subtract as a credit the proportional amount of sales and use tax paid on the equipment in another state. When filing a return, the contractor had to list each piece of equipment separately, along with the equipment's original purchase price, the amount of sales and use tax paid when the equipment was purchased, the state to which the tax was paid, the equipment's estimated useful life, and the period of time the equipment is expected to be in North Carolina.

Until 1989, the special use tax did not allow a credit for taxes paid in another state; accordingly, the tax operated as a protectionist measure to give North Carolina construction companies a competitive advantage over companies from other states. In 1989, the Revenue Laws Study Committee determined that without a credit for taxes paid in another state, the special use tax probably violated the federal constitution's interstate commerce clause. In addition, the committee found that retaliatory laws in neighboring states created a burden on North Carolina companies seeking to do construction business in those states. In accordance with the committee's recommendation, the 1989 General Assembly enacted the special use tax credit for regular sales and use taxes paid to other states and to local governments in other states.

Of our neighboring states, Virginia, South Carolina, and Tennessee have similar special use taxes on construction equipment brought into the state. Georgia does not have a similar tax. The border states that have a similar special use tax allow a credit for regular sales and use taxes paid in another state. Repeal of North Carolina's special use tax will therefore not affect North Carolina companies doing business in the border states; the companies will continue to receive credit for North Carolina sales and use taxes paid.

1995 Chapter 17 (Senate Bill 104, Sen. Cochrane)

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

This act makes a number of unrelated technical and clarifying changes to various revenue statutes. The changes are described below by section:

Section	Explanation
1.	Adds a missing period in the phrase "G.S".
2.	Deletes a duplicate word.
3-4.	Clarifies that a taxpayer's federal taxable income, used as a starting point for North Carolina corporate and individual income tax, is to be determined in accordance with the Internal Revenue Code.
5.	Requires a taxpayer to add to State taxable income the amount of any federal estate tax paid on an item of income in respect of a decedent that is included in federal taxable income. Under current law, taxpayers are allowed an income tax deduction for both State inheritance tax paid on an item of income in respect of a decedent and federal estate tax paid on the same item of income in respect of a decedent. Allowing a State deduction for a federal tax is contrary to the tax structure of the State and is the result of an oversight. This proposal corrects this oversight by repealing the deduction for federal estate tax but retaining the deduction for State inheritance tax paid on an item of income in respect of a decedent. Income in respect of a decedent is income to which a person was entitled when the person died. An example of an item of income in respect of a decedent is the gain from an installment sale made by the decedent before death. This income is subject to inheritance tax upon the death of the decedent as part of the decedent's property. An income tax deduction is allowed for the inheritance tax paid on an item of income in respect of a decedent to prevent double taxation.
6.	Changes the word "section" to "subsection."
7.	Makes a conforming change to the use tax statutes. In 1993, upon recommendation of the Revenue Laws Study Committee, the General Assembly enacted legislation providing that a retailer's sales tax license becomes void if, for a period of 18 months, the retailer does not file any returns showing taxable sales. This section makes the same change to the corresponding retail use tax license.

8. Corrects two incorrect cross-references and reorganizes and modernizes the current law allowing certain entities refunds of sales and use taxes.

9. Rewrites the definition of the Internal Revenue Code used in State tax statutes to change the reference date from January 1, 1994, to January 1, 1995. Updating the Internal Revenue Code reference makes recent amendments to the Code applicable to the State to the extent that State tax law previously tracked federal law. This update has the greatest effect on State corporate and individual income taxes because these taxes are based on federal taxable income and are therefore closely tied to federal law. The franchise tax, gift tax, highway use tax, inheritance tax, insurance company premiums tax, and intangibles tax also determine some exemptions based on the provisions of the Code. This year, because the federal government has not enacted any changes to the Code that affect our statutes, the update has no substantive effect and is merely a technical change.

10. Restores the correct time period for filing a petition for administrative review with the tax review board. This time period was inadvertently shortened in a rewrite of the statute enacted in 1993.

11. Adds three new exceptions to the prohibition against disclosing confidential tax information. The State's Tax Secrecy Act, G.S. 105-259, prohibits the disclosure of a taxpayer's tax information except in specified circumstances. The act fails to provide that the Department of Revenue may share a copy of a tax return with the taxpayer who filed it. This section corrects this problem in three ways: it allows the Department to provide a copy of a tax return (1) to the taxpayer who filed it, (2) to the legal representative of the estate of the taxpayer if the taxpayer is incompetent or deceased, or (3), in the case of a return filed by a partnership, a corporation, an estate, or a trust, to a "person having a material interest" as determined under the Code. A person having a material interest would be, for example, a partner in the partnership that filed the return, a corporate agent designated by the corporation's board of directors or CEO, a corporate shareholder with more than 1% of the outstanding stock, a shareholder in a Subchapter S corporation, the executor of an estate, or the trustee of a trust.

11.1 Gives a person who files an amended return after receiving a federal determination the same amount of time to ask for a refund that the Department of Revenue has to assess additional taxes. A federal determination is a change or correction made by the IRS to a federal tax that affects the person's liability for State income, gift, or withholding taxes. Last session, the General Assembly (in Chapter 582) revised and consolidated the provisions concerning assessments of tax following a federal determination and did not make a corresponding change to the statute of limitations for refunds.

11.2 Makes a conforming change to correspond to the change made by Section 11.1. The section deletes language in the statute that describes the procedure for claiming a refund that conflicts with the statute of limitations set in G.S. 105-266(c).

12. Adds a missing hyphen.

13. Restores a missing portion of a cross-reference.

13.1 Makes it clear that a motor carrier that operates in interstate, as opposed to intrastate, commerce must file a road tax report for each quarter whether or not the carrier drove in North Carolina during the quarter for which the report is due. The Department now requires these carriers to file quarterly reports but the statute can be construed as requiring them to file a report only if they drove in North Carolina during that quarter. When a motor carrier registers with the Department, the carrier must state on the application whether the carrier is an intrastate or an interstate carrier.

14-16. Consolidates, codifies, and conforms various local acts that authorize certain counties to acquire and improve public school property on behalf of their local school boards. These existing local acts authorize the named counties to finance school construction projects through lease-purchase. This section eliminates the confusion of having numerous similar local acts scattered throughout the Session Laws and provides that clarifying language that was included only in some of the more recent local acts will apply equally to all affected counties.

17. Chapter 681 of the 1993 Session Laws revised the State Ports Tax Credit. Because that tax credit expires for tax years ending after 2/28/96, the revisions to the credit need to expire at the same time.

18. Repeals a Session Law that duplicates another Session Law; both laws revised G.S. 105-241.1(e).

19-22. Clarifies that refunds of local meals taxes must be made only to certain nonprofit and government entities to the same extent as State sales tax refunds. The following local governments are currently authorized to levy a meals tax: Charlotte/Mecklenburg County, Dare County, Wake County, Cumberland County, and the Town of Hillsborough.

23. Repeals two 1971 acts that gave Nash County and Edgecombe County a special 1%¢ local option sales tax as an alternative to the 1%¢ local option sales tax enacted for all counties. These local acts provided that each county could levy or repeal the tax only if the other took the same action. These alternate local options were never exercised and are no longer viable because of subsequent changes in the State and local sales tax laws.

24. Provides that the sections of the act are effective upon ratification unless otherwise specified. Section 1 became effective July 1, 1995; Sections 5 and 9 became effective for taxable years beginning on or after January 1, 1995; and Section 11.1 and Section 18 became effective January 1, 1995. All other sections became effective March 23, 1995, the date of ratification.

Recommended by the Revenue Laws Study Committee.

1995 Chapter 21 (Senate Bill 220, Sen. Martin of Pitt)

AN ACT TO PROVIDE COUNTIES WITH INFORMATION TO ENABLE THEM TO VERIFY CLAIMS FOR REFUNDS OF THEIR LOCAL SALES AND USE TAX.

This act gives counties access to information regarding local sales tax refunds paid to nonprofit corporations and governmental entities, beginning July 1, 1995. Under prior law, counties did not have access to this information because the local sales tax is collected by the

State and the tax secrecy statute prevents the Department of Revenue from disclosing information about individual taxpayers. Without information about local sales tax refunds, counties were not able to audit claims for refunds against them. The counties had to rely on the Department of Revenue to audit the claims, but the Department does not have enough resources to provide the level of audit some counties wished to provide for themselves.

Under G.S. 105-164.14, nonprofit corporations and certain governmental entities may seek a refund of State and local sales taxes they pay on their purchases. To do so, these entities must file a written request for refund with the Department of Revenue and name the counties where the purchases were made. The Secretary of Revenue deducts the claimed refunds of local sales taxes from tax revenue distributed to the counties. Errors in identifying the correct county in refund claims occur because the local sales tax applies to the county in which the retailer is located, not the county in which the purchaser is located. Some counties believe that entities located in one county who pay sales tax to another county are claiming the refund against the county in which they are located, rather than against the county in which they made the purchase.

To obtain information concerning local sale tax refunds under this act, a county must request the information in writing from the Secretary of Revenue. The Secretary has 30 days to provide the chair of the board of county commissioners with a list of each nonprofit corporation or governmental entity that received a refund of at least $1,000 of that county's local taxes within the last 12 months. The county can then use this list to identify entities whose refund claims the county may wish to audit. Upon the written request of the county, this act requires an entity that has received a refund to provide the county with a copy of the request for refund, along with supporting documentation requested by the county to verify the request. If an entity determines that a refund it has received has been charged to the wrong county, it must file an amended return for the refund. The amended return will enable the Department to make the appropriate adjustments in the subsequent quarterly distribution of local sales tax revenue.

This act specifies that the information disclosed to the county is not a public record and may not be disclosed except in accordance with G.S. 153A-148.1, which governs the disclosure of local tax records. Section 2 of the act amends the tax secrecy statute to allow the Department to furnish the county with the required tax refund information.

During the first year the act is in effect, the Department of Revenue will have 90 rather than 30 days to provide a county the requested information. This extra time is allowed because the Department will have to compile the information manually. After the first year, it is anticipated that the new Integrated Tax Administration System will enable the Department to compile the information electronically.

1995 Chapter 41 (Senate Bill 8, Sen. Kerr)

AN ACT TO REPEAL THE INTANGIBLES TAX AND TO REIMBURSE LOCAL GOVERNMENTS FOR THEIR RESULTING REVENUE LOSS.

This act repeals the intangibles tax on stock, bonds, mutual funds, and accounts receivable effective for the 1995 tax year (taxes due April 15, 1996). The repeal will result in a tax reduction of $124 million a year for individuals and corporations. This act dedicates $93 million in recurring General Fund revenue for distribution to local governments annually to reimburse them for their revenue loss due to the repeal of the tax. A total of $95 million of State funds will be distributed to local governments for the intangibles tax because $2 million that was formerly deducted from the tax to pay for the Local Government Commission and

similar local cost items will instead be deducted from local sales taxes distributed to local governments.

The intangibles tax was a State-levied property tax of 25¢ per $100 of value of stocks, bonds, notes, mutual funds, certain accounts receivable, and interests in foreign trusts. Accounts with investment brokers and securities dealers were exempt from the tax on accounts receivable. Until 1985, the tax applied also to cash on hand, money on deposit, and accounts with investment brokers and securities dealers. These portions of the tax were repealed in 1985; at that time, the General Assembly dedicated recurring General Fund revenues for distribution to local governments to reimburse them for their revenue loss due to the repeal. The amount of the reimbursement was indexed to grow automatically at the same rate as State personal income.

Before 1937, the intangibles tax was levied by local governments. It was converted in 1937 to a State-levied tax with 50% of the revenue to be shared with local governments. The local share was increased to 75% in 1941 and to 100% in 1957. In 1991, in order to balance the State budget, the Governor cut local governments' share of the tax and their reimbursement for the parts of the tax repealed in 1985. Later that year, the General Assembly restored this cut but froze the distribution and reimbursement amounts, so that the State would share in the tax revenue as it grew above the frozen amount. In 1993, the General Assembly enacted legislation that would have frozen the State's share of the tax and restored future growth to local governments beginning in 1995. That legislation never went into effect, however, because the tax was repealed by this act.

By 1995, the State's share was approximately $31 million and the local share was approximately $93 million. By dedicating State revenue to reimburse local governments for their share in future years, this act requires the State to absorb the entire $124 million loss from the General Fund. Because the reimbursement to local governments is frozen and will not grow, local governments must absorb the loss of expected revenue growth that would have been restored to them in 1995 had the tax not been repealed.

The reimbursements enacted in 1985 and the new reimbursement provided in this act are allocated among the counties in proportion to the amount of tax collected in each county in the last year the tax that is being reimbursed was in effect. The amounts allocated are then divided among the county and its municipalities in proportion to the total amount of ad valorem taxes levied by each during the fiscal year preceding the distribution. The distributions will be made each August, beginning in 1995.

The repeal of the intangibles tax by this act was precipitated by litigation challenging the constitutionality of the tax on stocks and stock mutual funds. The stock tax statute exempted a proportion of corporate stock equal to the percentage of the corporation's business that is conducted in North Carolina. Thus, stock of a corporation that did 100% of its business in North Carolina was 100% exempt from the intangibles tax. This exemption was known as the "taxable percentage" deduction. In 1993, in Fulton Corp. v. Justus, the North Carolina Court of Appeals ruled that the taxable percentage deduction violates the interstate commerce clause of the federal constitution. The court invalidated the deduction effective for the 1994 tax year but, before the decision could go into effect, it was overturned by the North Carolina Supreme Court in December 1994. The North Carolina Supreme Court agreed with the State's argument that the stock tax and the taxable percentage deduction are both constitutional. The case is now on appeal in the United States Supreme Court. The plaintiffs are arguing that the entire stock tax is unconstitutional and should be invalidated by the court. If the 1995 General Assembly had not repealed the tax, taxpayers, the State, and local governments would have remained uncertain as to whether the court's decision would prohibit collection of the stock tax for the

1995 tax year, authorize collection of the tax but prohibit allowance of the taxable percentage deduction for the 1995 tax year, or leave the entire stock tax structure in place.

1995 Chapter 42 (House Bill 2, Rep. Daughtry)

AN ACT TO REDUCE INCOME TAXES FOR THE LOWER AND MIDDLE-INCOME PEOPLE OF NORTH CAROLINA BY INCREASING THE PERSONAL EXEMPTION DEDUCTION BY FIVE HUNDRED DOLLARS AND BY ALLOWING A TAX CREDIT OF SIXTY DOLLARS PER DEPENDENT CHILD.

This act, as amended by Chapter 370 of the 1995 Session Laws, provides income tax relief only to low and middle income taxpayers. The act will reduce the number of taxpayers by between 260,000 and 280,000 people. The tax relief provided by the act will result in a General Fund revenue loss of $235 million in fiscal year 1995-96 and $244.1 million in fiscal year 1996-97. The act makes the following changes in State individual income taxes:

1. Increases each personal exemption the taxpayer may claim by $250 for the 1995 taxable year if the taxpayer has an adjusted gross income less than the applicable amount listed below:

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

2. Increases each personal exemption the taxpayers may claim by an additional $250 for the 1996 taxable year if the taxpayer has an adjusted gross income of less than the applicable amount stated above.
3. Allows a tax credit of $60 per dependent child for taxpayers with adjusted gross incomes of less than the applicable amount stated above.

Increase in personal exemptions

Prior to this act, the State personal exemption amount of $2,000 had not been changed since 1989, when North Carolina began using federal taxable income as the starting point in calculating North Carolina taxable income. The State personal exemption is not indexed for inflation, as is the federal personal exemption. Therefore, to calculate North Carolina taxable income, a taxpayer must add back to federal taxable income the difference between the lower North Carolina personal exemption amount and the higher federal personal exemption amount.

The effect of this act is to require a lower amount to be added back each year for taxpayers whose adjusted gross income is less than the stated amounts. For the 1995 taxable year, the amount to be added back is $250 less than under the current law. For example, the federal personal exemption amount for the 1995 taxable year is $2,500. Under this act, the State personal exemption amount will be $2,250, rather than $2,000, for taxpayers whose adjusted gross income is less than the stated amounts. For taxpayers whose adjusted gross income is equal to or more than the stated amounts, the State personal exemption amount will remain at $2,000. For the 1996 taxable year and subsequent taxable years, the amount to be added back is $500 less than under the current law for taxpayers whose adjusted gross income is less than the stated amounts.

Credit for dependent children

The $60 tax credit for dependent children also applies only to taxpayers whose adjusted gross incomes are less than the stated amounts. The credit is in addition to the federal and state tax credits or exclusions for child care expenses. The new credit is allowed for each dependent child for whom the eligible taxpayer could take a federal personal exemption under section 151(c)(1)(B) of the Internal Revenue Code. That Code section allows an exemption for each dependent child who either is less than 19 years old at the end of the taxable year or is a student and is less than 24 years old at the end of the taxable year. A child is a son, stepson, daughter, or stepdaughter. A dependent child is a child over half of whose support was provided by the taxpayer.

1995 Chapter 46 (Senate Bill 120, Sen. Kerr)

AN ACT TO PROVIDE UNIFORM TAX TREATMENT OF NORTH CAROLINA OBLIGATIONS AND FEDERAL OBLIGATIONS.

This act provides that capital gains from the transfer of all State, local, and federal bonds will be subject to uniform State income tax treatment; it does this by repealing special State tax exemptions for capital gains from transfers of certain State and local bonds. The act becomes effective July 1, 1995, and applies to bonds issued on or after that date. It does not affect the tax treatment of capital gains on bonds issued before July 1, 1995.

This act was recommended by the Revenue Laws Study Committee to address an inconsistency in the State income tax treatment of capital gains from various bonds. The interest earned on federal bonds is exempt from State income tax, as is the interest earned on North Carolina State and local bonds. If the holder of a bond transfers it, there may be a capital gain. Gain from the transfer of federal bonds is subject to State income tax. Gain from the transfer of most North Carolina State and local bonds is also subject to State income tax. There are some State and local bonds, however, for which the bond law provides a State income tax exemption for gain from their transfer.

The Attorney General's Office notified the Department of Revenue, the State Treasurer, and the Revenue Laws Study Committee that allowing a tax exemption for gain from some North Carolina bonds but not for gain from federal bonds may violate the federal constitutional doctrine of intergovernmental tax immunity. In order to avoid constitutional problems, the State must treat federal and North Carolina bonds alike. To achieve uniform tax treatment for bonds, the General Assembly had the choice of either repealing the special capital gains exemption for a limited number of bonds or granting a tax exemption for capital gains from all federal bonds and all North Carolina State and local bonds. The Revenue Laws Study Recommended the former option. Repealing the special exemption is expected to cause only a small revenue increase, for three reasons: (1) there are relatively few bonds affected, (2) North Carolina bonds are not generally traded for capital gains, and (3) some bondholders are probably not aware of the tax exemption and are not currently claiming it. The other option, exempting the capital gain from all bonds, would have caused a General Fund revenue loss that was expected to be of greater magnitude because it would involve a much larger group of State and local bonds as well as all federal bonds. The amount of the potential loss to the General Fund was unknown due to a lack of data.

In addition to repealing the special capital gains exemption for a select group of State and local bonds, this act makes other two changes. First, it clarifies that bonds are not exempt from franchise tax or inheritance and gift tax; some bond statutes are ambiguous on this point,

but the statutes have not been interpreted as granting a special exemption from these taxes. Second, in Section 1, it repeals a 1955 law authorizing the creation of business development corporations and allowing them to issue bonds. This law has never been used and is now obsolete.

This act is not expected to affect the marketability of State or local bonds, whether outstanding or issued in the future. The tax changes in the act do not apply to any bonds issued before July 1, 1995. Future issues of State and local bonds in the following categories will be subject to the same capital gains tax treatment as other bonds:

- Bonds of the Global TransPark Authority, a State agency
- Bonds of the Nash-Edgecombe merged school administrative unit
- Revenue bonds of the Higher Education Facilities Finance Agency, a State agency
- Revenue bonds of The University of North Carolina system
- Revenue bonds of the State Education Assistance Authority, a State agency
- Bonds of the N.C. Housing Finance Agency, a State agency
- Bonds of the N.C. Agricultural Finance Authority, a State agency
- Bonds of the N.C. Medical Care Commission, a State agency
- Revenue bonds of public hospital authorities created by local governments
- Refunding bonds issued by the State
- Bonds of the N.C. State Ports Authority, a State agency
- Bonds of local government housing authorities
- Bonds issued by municipalities or joint municipal power agencies to finance electrical power projects
- Special obligation bonds issued for solid waste capital projects by local governments or by the N.C. Solid Waste Management Capital Projects Agency, a State agency
- Bonds issued by local government housing agencies

1995 Chapter 50 (House Bill 122, Rep. Arnold)

AN ACT TO EXPAND THE ALLOWABLE USES OF TRANSPORTER PLATES, TO ALLOW OWNERS OF SALVAGE VEHICLES TO RETAIN TITLE TO THE VEHICLES, AND TO EXEMPT OUT-OF-STATE UTILITY VEHICLES THAT ARE USED IN CERTAIN EMERGENCY OPERATIONS FROM THE VEHICLE REGISTRATION AND ROAD TAX REQUIREMENTS.

This act makes several unrelated changes to the laws concerning motor vehicles. The changes expanding the allowable uses of transporter plates only for special mobile equipment and providing a highway use tax exemption and a reduced title fee for the transfer of a salvage vehicle when the transfer was from an insurance company to the person who owned the vehicle when it became a salvage vehicle were recommended by the Revenue Laws Study

Committee. The changes made by this act are expected to reduce the Highway Trust Fund by approximately $171,600 a year and the Highway Fund by approximately $32,400 a year.

Transporter plate changes

The act allows transporter plates to be used on vehicles in two new circumstances. The first circumstance is to drive special mobile equipment from the manufacturer of the equipment to the facility of the special mobile equipment dealer, from one facility of the dealer to another, or from the dealer to the buyer of the equipment. The second circumstance is to move a motor vehicle that is owned by a business and is a replaced vehicle offered for sale; under current law only a utility may obtain a transporter plate to move a replaced motor vehicle. The changes are effective upon ratification.

A transporter plate is a type of commercial license plate. A transporter plate is issued on a calendar-year basis, can only be used for a purpose that is listed in the statutes, and can be transferred from one vehicle to another during the year as long as the vehicle to which it is transferred is driven for one of the authorized business purposes. It differs from a dealer plate in its restrictions on use. A vehicle bearing a dealer plate can be driven for any purpose as long as the driver is an officer or an employee of the dealer. The fee for a transporter plate is $10.

Under the law prior to the enactment of this act, a special mobile equipment dealer had to use a dealer plate to drive special mobile equipment on the highway. The number of dealer plates available to a dealer is based on the dealer's sales volume. A dealer in special mobile equipment might sell fewer than 12 pieces of special mobile equipment in a year, and based on that sales volume, may be entitled to only one dealer plate. This part of the act alleviates this problem by allowing the special mobile equipment dealer to use either transporter plates or dealer plates for the three limited transport purposes.

Special mobile equipment is a class of vehicles; the class consists of vehicles that have permanently attached special equipment whose purpose is to perform off-road work. Truck cranes and well-drilling rigs are two types of special mobile equipment. Special mobile equipment is driven on the roads only to get to off-road jobs. It is subject to sales tax rather than highway use tax and pays a flat annual registration fee of $20 rather than a fee based on weight.

Salvage vehicle changes

The act eliminates the double title transfer now required when a vehicle is wrecked to the extent it is a salvage vehicle and the owner wants to keep the vehicle. Under the prior law, the owner had to transfer the vehicle to the insurer and the insurer had to then transfer the vehicle back to the owner. A salvage vehicle is one on which a claim has been paid that exceeds 75% of the fair market value of the vehicle, as determined by the National Automobile Dealers' Association Pricing Guide Book or another pricing guide approved by the Commissioner of Motor Vehicles. In place of the double transfer, the act requires the owner of the salvage vehicle to sign a form acknowledging the status of the vehicle as a salvage vehicle. This change became effective July 1, 1995.

For those salvage vehicles retained by their owners, eliminating the double title transfer means that the insurer will not have to pay the $10.00 fee that applies to transfers of salvage vehicles to an insurer and that the owner will not have to pay the highway use tax and $35 title fee that applies to transfers of titles in general. The insurer and the owner will not have to pay these fees because there will be no title transfer that triggers their payment.

Utility vehicles

The act exempts utility vehicles that are licensed in another state and are used in this State in an emergency to restore utility service from two different registration requirements. The two requirements from which the vehicles are exempt are (i) the requirement to register with the Division of Motor Vehicles and pay an apportioned license fee and (ii) the requirement to register with the Department of Revenue and pay a road tax based on the number of miles driven in the State. These changes were recommended to the 1994 General Assembly by the Joint Legislative Utility Review Committee. They passed the House of Representatives during the 1994 biennium as part of a larger bill, but the larger bill did not pass the Senate. These changes become effective October 1, 1995.

1995 Chapter 89 (Senate Bill 245, Sen. Hartsell)

AN ACT TO AUTHORIZE THE OPENING OF EMPTY LOCK BOXES OF DECEDENTS OUTSIDE THE PRESENCE OF THE CLERK OF SUPERIOR COURT, AS RECOMMENDED BY THE GENERAL STATUTES COMMISSION.

This act, which was recommended by the General Statutes Commission, establishes a procedure to allow a decedent's safe deposit box to be opened outside the presence of the Clerk of Superior Court if the box is empty. Under current law, financial institutions managing safety deposit lock boxes may not open a box after the death of the box holder unless someone from the clerk of court's office is present. When the box is opened, the clerk makes an inventory of its contents and furnishes a copy to the Secretary of Revenue for inheritance tax purposes. This requirement serves no purpose in cases in which the box is empty.

Under this act, if the personal representative of an estate believes the box may be empty, the representative may request the clerk of court to authorize the box to be opened outside the presence of an employee of the clerk of court. With this permission, the box may be opened in the presence of a representative of the financial institution, who must certify that the box is empty. No notice is sent to the Department of Revenue. If the box is not empty, the box must be closed immediately and reopened only in the presence of the clerk. This act becomes effective October 1, 1995, and applies to the estates of decedents dying on or after that date.

1995 Chapter 109 (House Bill 213, Rep. Bowie)

AN ACT CONCERNING THE COLLECTION OF DELINQUENT TRUCK PENALTIES AND ASSESSED TAXES AND THE CONSOLIDATION OF THE VARIOUS PROVISIONS CONCERNING OVERWEIGHT VEHICLES.

This act clarifies the law concerning the authority of a law enforcement officer of the Division of Motor Vehicles (DMV) to detain a truck until any delinquent penalties or taxes previously assessed against the truck's owner for motor carrier vehicle violations or motor carrier taxes have been paid. It also consolidates the various provisions concerning the weighing of trucks and eliminates inconsistencies in these provisions. The act becomes effective October 1, 1995. It is one of the recommendations of the Joint Legislative Transportation Oversight Committee to the 1995 General Assembly.

G.S. 20-96 authorizes the detention of a truck "with an overload as described in this section or which is equipped with improper registration plates, or the owner of which is liable for any overload penalties or assessments applicable to the vehicle and due and unpaid for more than 30 days." This language can be construed to mean that a vehicle can be detained only when it has an overload, has improper registration plates, or has an overdue overweight

penalty assessed against that particular truck. However, in practice, a DMV law enforcement officer can detain a truck when the officer finds that the truck's owner has previously been assessed a penalty for a motor carrier vehicle violation and payment of the penalty is overdue. Penalties are due upon assessment and become delinquent 30 days after the date of assessment. Motor carrier vehicle violations include registration, equipment, and overweight violations. A DMV officer can also detain a truck when the officer finds that the trucks' owner is delinquent in paying motor carrier road taxes due under Article 36B of Chapter 105 of the General Statutes. This act rewrites G.S. 20-96 to make it clear that the authority applies to all motor carrier vehicle violations and to delinquent motor carrier taxes.

The act also consolidates the statutory provisions on the weighing of trucks and eliminates inconsistencies in those provisions. Currently, G.S. 20-96 has several inconsistencies. First, it states that overweights are subject only to axle-group penalties, and not single-axle or tandem-axle weight limit penalties. Second, it states that overweights on light-traffic roads are subject only to single-axle or tandem-axle penalties, and not axle-group penalties. Both of those statements conflict with G.S. 20-118. Third, it refers to a tax that was repealed years ago.

1995 Chapter 329 (Senate Bill 496, Sen. Blackmon)

AN ACT TO ALLOW LOCAL GOVERNMENTS TO FORGO COLLECTION OF AD VALOREM TAX BILLS WHEN THE ORIGINAL PRINCIPAL AMOUNT DUE IS UNDER FIVE DOLLARS.

This act gives the governing body of a taxing unit that collects its own taxes the authority to adopt a resolution directing the tax collector not to collect property taxes when the amount of tax due is less than the amount set in the resolution. The amount set may not exceed $5.00 and should be the amount it would cost the taxing unit to send a tax bill. All of the taxes and fees due on a tax receipt or on a motor vehicle property tax notice, including those taxes and fees of other units for which it collects taxes, are included in determining whether the amount due is less than the threshold set by the taxing unit.

Under current law, the governing body of a taxing unit may permit its tax collector to treat small underpayments of taxes as fully paid and to not refund small overpayments of taxes unless the taxpayer requests a refund. The statute defines "small" as $1.00 or less. This act expands that concept, by allowing taxing units to eliminate billing and collection of minimal taxes up to $5.00. As with small underpayments and small overpayments, the tax collector must keep a record of the taxes by taxpayer and amount and must report the amount of taxes to the governing body as part of the settlement for the year.

The act is effective July 1, 1995, which is the beginning of the 1995-96 tax year. To authorize the tax collector not to collect minimal taxes for a tax year, the governing body must adopt a resolution to that effect by June 15 preceding the first day of the tax year (July 1). The resolution remains in effect for subsequent tax years until amended or repealed by another resolution of the taxing unit. Because this act was ratified June 26, 1995, it gives taxing units an extension until June 30, 1995, to adopt a resolution for the 1995-96 tax year.

The General Assembly had earlier ratified as Chapter 24 of the 1995 Session Laws an act that allowed counties not to bill for motor vehicle property taxes when the amount due on the tax bill is less than the cost of preparing and sending the bill. That act was repealed by this act because this act will cover motor vehicle property taxes as well as all other property taxes. If a county adopted a resolution under Chapter 24 before its repeal, the resolution will be effective under this act.

1995 Chapter 340 (House Bill 123, Rep. Arnold)

AN ACT TO REVISE THE CONTROLLED SUBSTANCE EXCISE TAX.

This act revises the State excise stamp tax on controlled substances to bring it in line with a 1994 decision of the United States Supreme Court. The act becomes effective October 1, 1995, and is expected to have a minimal negative impact on excise stamp tax collections.

On June 6, 1994, the United States Supreme Court ruled that Montana's tax on illegal drugs was unconstitutional. In Montana v. Kurth Ranch, 114 S.Ct. 1937 (1994), the court held that the tax was in fact a punishment, not a true tax, and thus violated the Fifth Amendment's double jeopardy clause that protects against multiple punishments for the same offense. The court acknowledged that a tax is not necessarily a punishment if it is at a high rate and is designed to deter unlawful conduct; the court also acknowledged that an unlawful activity may be taxed. The court found that Montana's tax crossed the line from a tax to a punishment because, in addition to being on an illegal activity, at a high rate, and designed to deter undesirable behavior, the tax was conditioned on the commission of a crime and was exacted only after the taxpayer was arrested and the taxed drugs were no longer in the taxpayer's possession. The court based its decision on its finding that under Montana law, a taxpayer has no obligation to file a return or pay tax unless and until the taxpayer is arrested for illegal possession of the drugs. Four Justices dissented from the court's decision.

North Carolina levies an excise stamp tax on the possession of illegal drugs. The tax is at the rates of $3.50 for each gram of marijuana, $200 for each gram of any other drug sold by weight, and $400 for each 10 dosage units of any drug not sold by weight. Seventy-five percent (75%) of the tax proceeds received due to an assessment of the tax are distributed to the law enforcement agency that conducted the investigation leading to the assessment; the remaining tax proceeds are credited to the General Fund.

The Attorney General's Office reviewed the opinion in Montana v. Kurth Ranch and concluded that North Carolina's drug tax law is not unconstitutional because it differs from the Montana law in one key respect: the North Carolina law applies whether or not a person is arrested for a drug violation. North Carolina law requires a person who acquires more than a minimum amount of illegal drugs to pay the tax within 48 hours and place stamps on the drugs to show that the tax has been paid. In other respects the North Carolina law is similar to Montana's: it is at similar rates, it is designed to deter undesirable behavior, and it applies only to drugs possessed in violation of the criminal law.

The act makes the following changes to North Carolina's drug tax law to remove any aspects of the tax that could indicate that the tax is a punishment rather than a true tax designed to raise revenue; these changes were recommended by the Revenue Laws Study Committee on the advice of the Attorney General's Office and the Controlled Substance Tax Division of the Department of Revenue.

1. It clarifies that the purpose of the tax is to raise revenue for law enforcement and for the General Fund rather than to provide a second punishment.
2. It revises the tax rates so that they do not, in general, exceed the market value of the various illegal drugs. The act imposes a lower tax rate on low-street-value drugs, which include steroids, depressants, stimulants, and hallucinogenic substances. It also imposes a lower tax rate on stems and stalks of marijuana that have been separated from other parts of the plant. Separated stems and stalks are usually the debris left over from harvesting marijuana and are of much less value in this form. The failure

of Montana's drug tax to provide lower tax rates for lower value drugs was a key factor in the court decision finding the tax unconstitutional.

3. It provides that the tax applies to any actual or constructive possession of drugs, with an exemption for a person who is authorized by law to possess the drugs. Currently, the tax applies to anyone who possesses drugs in violation of criminal drug statutes.
4. It repeals the special law that makes failure to pay the drug tax a felony. Other tax laws are covered by the general tax penalty provisions of G.S. 105-236, which criminalize only intentional conduct. Under the act, the drug tax is subject to the same penalty provisions as other tax laws.
5. It reduces the civil penalty for failure to pay the drug tax from 100% of the tax due to 50% of the tax due, so it will be the same as the penalty for failure to pay the tobacco tax. The 100% drug tax penalty has been imposed but, as a practical matter, is virtually never collectible.
6. It repeals the tax on counterfeit controlled substances, which do not have the same value as true controlled substances.
7. It clarifies that the proceeds of the tax may be distributed more frequently than quarterly.

1995 Chapter 349 (House Bill 768, Rep. Sexton)

AN ACT TO PROVIDE THAT THE HIGHWAY USE TAX TRADE-IN ALLOWANCE APPLIES WHEN TWO CARS ARE EXCHANGED FOR ONE ANOTHER.

This act specifies in the statutes that an exchange of motor vehicles between two parties is a sale under the highway use tax. An exchange between two parties has always been considered a sale under the highway use tax, so the act does not change the law on this subject. The act became effective July 1, 1995. Because the act does not change the law, the act has no fiscal impact.

The definition of "sale" in G.S. 105-164.3(15) that applies to the highway use tax specifically includes an exchange of property. The Division of Motor Vehicles, which administers the tax, has followed this definition and treated exchanges as sales.

If a transaction is a sale under the highway use tax, the amount on which the highway use tax is computed is reduced by the amount of any trade-in allowance. The amount on which highway use tax is computed is the market value of the vehicle. If a seller of a vehicle is not a car dealer, the market value of the vehicle is presumed to be the wholesale book value of the vehicle. The amount allowed as a trade-in allowance, however, is not based on market value. The amount allowed as a trade-in allowance is the amount determined by the seller to be the value of the vehicle.

The effect, therefore, of treating a two-party exchange of vehicles as two sales is to allow a trade-in allowance to be applied to each sale, thereby reducing the amount on which highway use tax is computed. If each seller gives a trade-in allowance equal to the market value (wholesale book value) of the vehicle owned by the seller at the time of the exchange, no highway use tax will be due because the market value of the vehicle less the trade-in allowance will be zero.

The highway use tax was enacted in 1989 to provide revenue for the Highway Trust Fund. It replaces the former sales tax on motor vehicles. The highway use tax is 3% of the retail value of a motor vehicle, subject to both a minimum tax that applies until July 1, 1996, and to a maximum tax. The minimum tax, which is repealed effective July 1, 1996, is $40.00. The maximum tax is $1,500 for automobiles and other vehicles that weigh no more than 26,000 pounds and is $1,000 for vehicles that weigh more than 26,000 pounds. The highway use tax is payable when a certificate of title is issued for a motor vehicle. The tax is in addition to the $35.00 fee that is charged for the issuance of a title and the $10.00 or $20.00 fee that is charged for the transfer or issuance of a license plate.

1995 Chapter 350 (House Bill 1058, Rep. McComas)

AN ACT TO MAKE CONFORMING CHANGES TO THE TAX LAW IN LIGHT OF FEDERAL LAW PREEMPTING STATE REGULATION OF MOST MOTOR FREIGHT CARRIERS.

This act amends the property tax laws and the corporate income tax laws to preserve the existing property tax and income tax treatment of for-hire motor carriers of property. Because of changes in federal law, these motor carriers did not fit the statutory definitions that applied prior to the effective date of this act. This act became effective June 29, 1995. The act is not expected to have a fiscal impact.

A federal act passed in the fall of 1994 prohibits federal or state regulation of rates, routes, and service of trucking companies, other than those that carry household goods. Until this prohibition, the North Carolina Utilities Commission regulated intrastate trucking companies and the Interstate Commerce Commission (ICC) regulated interstate trucking companies. The North Carolina Utilities Commission can no longer regulate these intrastate trucking companies, and the ICC's regulation of interstate trucking companies has been greatly reduced.

The state property tax and income tax definitions of trucking companies that were in effect when the 1994 federal act became effective referred to trucking companies as being regulated by the Utilities Commission or the ICC. Because of the change in the scope of regulation, these definitions no longer applied. The act therefore modifies the definitions to ensure that the change in regulation does not inadvertently cause a change in the way the trucking companies pay property and income taxes.

Under the State property tax laws, the "rolling stock" (vehicles) of all intrastate trucking companies that have two or more terminals in the State and of all interstate trucking companies that do business in the State is valued by the Department of Revenue rather than by the county assessor of the counties in which the company's terminals are located. The value of the vehicles is then allocated among the counties in which the terminals are located in proportion to the percentage (tonnage) of freight handled at each terminal during the preceding year. This method of taxation avoids the problem of multiple counties trying to tax the same property.

If the trucking company does business outside the State, the Department of Revenue must determine the share of the company's property that is taxable in this State and will therefore be allocated among the counties. This determination is made on the basis of mileage in this State. Similarly, under the corporate income tax, the income of a trucking company that does business in more than one state is allocated among those states based on the number of vehicle miles traveled in each State.

1995 Chapter 360 (House Bill 994, House Appropriations Committee)

AN ACT TO IMPLEMENT THE RECOMMENDATIONS OF THE COMMITTEE ON APPROPRIATIONS BY CHANGING VARIOUS REVENUE STATUTES.

This act contains a variety of changes that concern either insurance taxes and fees or the payment of administrative costs under the Setoff Debt Collection Act. The changes were recommended by the House and Senate Appropriations Committees as part of the biennial State budget and were revised by the House and Senate Finance Committees.

Section 1 of this act transfers the responsibility of collecting part of the premiums tax imposed on insurance companies from the Department of Insurance to the Department of Revenue, effective January 1, 1996. This responsibility will cost the Department about $100,000 a year, with additional one-time costs of about $200,000 in the 1995-96 fiscal year. These amounts were appropriated to the Department of Revenue in the expansion budget, Chapter 570 of the 1995 Session Laws.

Under G.S. 105-228.5, insurance companies pay taxes based on their gross premiums instead of paying corporate income and franchise taxes. In addition, employers that carry their own workers' compensation risk, known as self-insurers, and employers that pool their workers' compensation liabilities pay the gross premiums tax on premiums they pay or on the premiums that would be charged to cover the risk. The workers compensation premiums tax rate is 2.5% of gross premiums and the general premiums tax rate is 1.9% of gross premiums. The tax rate on receipts of nonprofit companies providing hospital, medical, and dental coverage is 0.5%. Insurers that provide fire and lightning coverage pay an additional tax at the rate of 1.33% of gross premiums for fire and lightning coverage provided on property other than vehicles and boats.

Section 1 of this act provides that collection of the 2.5% tax on workers' compensation self-insurers and the additional 1.33% tax on fire and lightning coverage remains with the Department of Insurance. Collection of the 2.5% tax on other workers' compensation premiums and of the rest of the premiums tax is transferred to the Department of Revenue. This section also reorganizes and modernizes the language of the gross premiums tax statutes, clarifies that interest on installment overpayments of gross premiums tax is calculated the same way as interest on installment overpayments of corporate income tax, and deletes from Article 2 of Chapter 97 of the General Statutes, the Workers' Compensation Act, redundant and inaccurate provisions about the collection of the tax on workers' compensation insurance.

Section 2 of this act eliminates the insurance audit and examination fees for insurance companies, HMOs, medical corporations, and guaranty associations, effective July 1, 1995. Under current law, when the Insurance Department audits an insurer or a rate organization, it charges the cost of the audit to the company as a fee. The act repeals these fees. Consequently, the costs of the audits will be paid for by the insurance regulatory charge as part of the costs of regulating the insurance industry. The Fiscal Research Division estimated that the amount of fee revenue that will be replaced by regulatory charge revenue is $4.5 million a year.

Section 3 of this act expands the purposes for which the insurance regulatory charge is to be used, effective July 1, 1995, to include costs incurred by other departments as well as by the Department of Insurance in regulating the insurance industry. The insurance regulatory charge, which is a percentage of gross premiums tax liability, was imposed on insurance companies in 1991 in order to make the Department of Insurance receipt-supported and thereby eliminate General Fund support of that department. Its use was limited to paying the

cost to the Department of Insurance of regulating the insurance industry and other industries as well as the State's costs incidental to the Department of Insurance's costs. Section 3 removes the limitation that costs payable from the charge must be incurred by the Department of Insurance; this change is designed to include in the costs that are paid from the charge the costs of the Attorney General's Office in providing counsel on insurance matters. To reflect the broader application of the insurance regulatory charge, Section 3 also changes the name of the fund to which the charge is credited from the Department of Insurance Fund to the Insurance Regulatory Fund and specifies that this fund is to be administered by the Office of State Budget and Management.

Section 4 of this act changes the administrative reimbursement under the Setoff Debt Collection Act by excluding child support collections from payment of the administrative costs, effective January 1, 1996. The Setoff Debt Collection Act is the law under which the Department of Revenue retains an income tax refund of an individual who owes money to a claimant agency and sends the refund to the claimant agency to be applied to the debt. The Department pays for this program by deducting its administrative costs from amounts collected on behalf of all claimant agencies. The Department of Human Resources and county agencies are claimant agencies that use the debt setoff program to collect child support arrearages pursuant to the federal Child Support Enforcement Program. This section provides that the Department of Revenue will no longer deduct its administrative costs from amounts collected for child support arrearages, but it will continue to receive the same amount of reimbursement as under the current law by spreading among other claimant agencies the portion of the Department's administrative costs now deducted from child support collections. Thus, a greater percentage of other debts collected will be deducted for administrative costs. The Fiscal Research Division has estimated that approximately $300,000 a year in child support setoff administrative costs will be shifted from child support collections to other setoff collections, resulting in an increase in the percentage deducted from those other collections from the current 7% to about 14% of the amount collected.

Section 5 of this act repeals a provision in the 1995 continuation budget that made certain budget reductions contingent on enactment of this act. Because this act has been enacted, the contingency language in the budget is not needed.

1995 Chapter 370 (House Bill 142, Rep. C. Wilson)

AN ACT TO MAKE TECHNICAL CHANGES RELATING TO THE REPEAL OF THE INTANGIBLES TAX AND TO OTHER TAX LAWS.

Sections 1 through 3 of this act make clarifying and technical changes to acts enacted during the 1995 session. Sections 4 through 6 make clarifying changes and technical corrections to laws enacted in previous sessions.

Sections 1 and 2 make changes to Senate Bill 8, Intangibles Repeal/Hold Harmless, enacted as Chapter 41 of the 1995 Session Laws. Section 1 inserts a cross-reference to the Department's costs of administering the intangibles tax reimbursement. The effect of the cross-reference is to maintain the Department's current authorization to deduct from local government revenues its costs of administering the intangibles tax distributions. Section 2 makes technical wording changes so that the various intangibles tax reimbursement allocations will read the same. These sections became effective July 1, 1995; the Fiscal Research Division reported that they have no fiscal impact.

Section 3 of this act makes a clarifying change to the personal exemption increase enacted by House Bill 2, Income Tax Cut/Child Care Credit as Chapter 42 of the 1995 Session Laws. The additional language added by the increased exemption was slightly ambiguous and might have been misconstrued to require an inflation adjustment only if the taxpayer's adjusted gross income was below the thresholds set in the act. The inflation adjustment—an addition to taxable income—is required of all taxpayers, however. This section becomes effective for the current tax year and has no fiscal impact.

Section 4 of this act clarifies the amount of a deduction a corporation may take as a charitable contribution for donating land for conservation purposes when it also takes a credit for the donation under G.S. 105-130.34. That statute allows a credit of 25% of the value of the land, up to a maximum credit of $25,000. This section clarifies that a deduction is allowed for the excess value of the land over the value used in computing the credit, rather than the excess value over the amount of the credit itself. For example, if the value of the land is $120,000, the credit is 25% of that value, $30,000, capped at $25,000. Because the credit is based on the first $100,000 of land value, a deduction is allowed only for the remaining $20,000 of value. Before clarification by this section, the current provision could have been construed to allow a deduction in this circumstance for $95,000, which is the excess value of the land over the amount of the credit allowed. This section becomes effective for the current tax year and could result in a minor increase in General Fund tax revenue.

Sections 6 and 7 of this act correct errors in the jobs tax credit statutes that reverse the proper order of the county rankings based on population. The correct order is highest to lowest instead of lowest to highest. These sections are effective upon ratification and have no fiscal impact.

1995 Chapter 390 (Senate Bill 943, Sen. Kerr), as amended by Sections 32.1 and 32.2 of Chapter 523

AN ACT TO ADDRESS MOTOR FUEL TAX EVASION AND TO IMPROVE THE ADMINISTRATION OF THE MOTOR FUEL TAXES BY CHANGING THE POINT OF TAXATION OF GASOLINE AND DIESEL FUEL, TO REPEAL THE MINIMUM HIGHWAY USE TAX, AND TO STRENGTHEN THE ENFORCEMENT OF THE ROAD TAX PAID BY MOTOR CARRIERS.

This act makes several significant changes to the motor fuel tax laws and to the highway use tax laws. The changes become effective at various times as explained. The changes are expected to generate net annual additional Highway Trust Fund revenue of $10 million when all the changes have become effective.

First, the act establishes a uniform system for the collection of the per gallon motor fuel excise taxes on gasoline and clear diesel. Under the system, fuel is taxed when it is removed at a "rack" at a motor fuel terminal. Under current law, gasoline is taxed on its first sale after the rack and clear diesel is taxed when it is sold to a person who is going to either resell it at a service station to operate highway vehicles or store it for subsequent use in highway vehicles the person owns. Parts I, II, and III of the act make this change, effective January 1, 1996.

Second, the act repeals the $40 minimum highway use tax that is payable when the title to a vehicle is transferred, effective July 1, 1996. Part IV of the act makes this change.

Third, it establishes a minimum mileage presumption for motor carriers that drive in the State but do not report mileage to the State and imposes increased penalties for motor carriers

that understate mileage to the State by more than 25%. Part V of the act makes these changes, effective October 1, 1995.

Uniform System For Motor Fuel Tax Collection

Part I of the act repeals the current laws on the collection of motor fuel excise taxes and replaces them with new laws on this subject. The new laws move the point of collection for the per gallon motor fuel excise taxes to the terminal, thereby eliminating opportunities for tax evasion and making the system easier to administer. North Carolina is particularly vulnerable to motor fuel tax evasion because its motor fuel tax rate is 21.95¢ a gallon compared to 16¢ a gallon in South Carolina and 7.5¢ a gallon in Georgia.

The new system will eliminate opportunities for tax evasion by reducing the availability of non-tax-paid fuel purchased in this State and by having a large part of the tax on imported fuel collected by out-of-state suppliers. The proposed system will be easier to administer because it will parallel the federal system as well as South Carolina's and the number of taxpayers will be greatly reduced.

Part II of the act provides for transitional provisions to facilitate the change to the new system. Part III of the act makes conforming changes to various statutes that refer to motor fuel laws. The following outline summarizes the distinctions between the act and the current law:

Subject	Chapter 390	Current Law
Taxing Point	Removal from terminal	Gasoline—first sale Diesel—last sale before highway use
Taxpayer	Distributor; supplier is trustee and will collect tax from distributor and remit to state	Distributor, who pays directly to state
Tax Due Date	22nd of each month; licensed distributor can pay supplier the same date that supplier must pay state	Gasoline—20th Diesel—25th
'Tare' Allowance	Licensed distributor gets 1% on taxable gasoline and diesel plus quarterly hold-harmless	2% on first 150,000 1 ½% on next 100,000 1% on excess over 250,000 and tare applies to exempt government sales; Diesel distributor does not get tare
Supplier Allowance	1/10 of 1%, with $8,000 monthly maximum	None. Supplier does not collect from distributors and remit to the state
Tax on Imports	Reported and paid by distributor	Paid mainly by elective or permissive supplier; Paid in part by one of three types of importers: bonded, occasional, and tank wagon

Subject	Chapter 390	Current Law
		Import verification number required
Bond Amounts	$2,000,000 for refiner, supplier, terminal operator, and bonded importer. Two times monthly liability with minimum of $2,000 and maximum of $250,000 for distributor, occasional importer, tank wagon importer, blender	Gasoline: two times monthly liability with minimum of $2,000 and maximum of $125,000 Diesel: two times monthly liability with minimum of $500 and maximum of $125,000
Exemptions	Same as current law	Exports, sales to federal government, sales to state, sales to local boards of education
Refunds	Motor fuel delivery vehicle, accidental mixes, lost diesel fuel, and clear diesel bought by marinas; otherwise, the same	Exempt government sales, exports, cities and counties, a few nonprofits, taxis, cement mixers, garbage compactors, and a few other vehicles that have power equipment, and off-highway uses
Enforcement	Same shipping document plus import verification number	Destination state shipping document

Repeal of Minimum Highway Use Tax

Part IV of the act repeals the minimum $40 highway use tax, effective July 1, 1996. Section 30 of that Part repeals the tax. Sections 31, 32, and 33 are conforming changes to references to the minimum tax. Section 34 adjusts revenue between the Highway Fund and the Highway Trust Fund to ensure that the Highway Trust Fund does not lose revenue.

The highway use tax was enacted in 1989 as part of the Highway Trust Fund legislation to provide revenue for that Fund. The highway use tax replaces the former sales tax on motor vehicles. The highway use tax is 3% of the retail value of a motor vehicle, subject to both a minimum and a maximum tax. The minimum tax is $40.00. The maximum tax is $1,500 for automobiles and other vehicles that weigh no more than 26,000 pounds and is $1,000 for vehicles that weigh more than 26,000 pounds.

The highway use tax is payable when a certificate of title is issued for a motor vehicle. The tax is in addition to the $35.00 fee that is charged for the issuance of a title and the $10.00 or $20.00 fee that is charged for the transfer or issuance of a license plate. Thus, the minimum combined tax and fees payable when a certificate of title is transferred as the result of the sale of a motor vehicle is $85.00 if the new owner transfers a license plate to the vehicle and is $95.00 if the new owner obtains a new license plate for the vehicle. These figures are the result of adding the $40.00 tax, the $35.00 title fee, and either the $10.00 or $20.00 fee for a license plate.

The $40.00 minimum tax is regressive and does not distinguish between motor vehicles valued at less than $1,300. The transfer of a boat trailer, for example, that has a value of $150 triggers the payment of at least $85.00 in taxes and fees while the transfer of a car valued at $1,300 triggers payment of the very same amount of taxes and fees.

Since the enactment of the tax, the Revenue Laws Study Committee and the Division of Motor Vehicles of the Department of Transportation have received numerous complaints about the high minimum amount that must be paid to transfer a certificate of title. According to the Director of Vehicle Registration of that Division, the high minimum tax on utility trailers and other low-value vehicles is the number one complaint from the public about the highway use tax. Part IV of this act responds to these complaints by repealing the minimum tax.

Motor Carrier Enforcement Changes

Part V of the act makes changes to the road tax that are designed to increase compliance with that tax. It establishes a minimum mileage presumption for motor carriers that drive in the State, as evidenced by records of the Division of Motor Vehicles, but either do not report mileage to the State or underreport mileage. The presumption is 10 trips of 450 miles each for each of the carrier's vehicles.

The act also imposes an increased penalty on motor carriers that understate their mileage to the State by more than 25%. Under current law, the penalty for negligently understating the amount of tax owed is 10% of the deficiency. This act increases the penalty for motor carriers that understate their mileage by more than 25% to an amount equal to two times the amount of the deficiency. This Part becomes effective October 1, 1995.

The purpose of the road tax is to tax motor carriers who drive in the State using fuel purchased in another State. The road tax on motor carriers is set at the same rate as the per gallon excise tax and a credit is given for any State per gallon excise taxes paid. The number of miles a motor carrier drives in North Carolina in a reporting period and the total amount of fuel consumed by the motor carrier in that reporting period determine the motor carrier's road tax liability.

1995 Chapter 404 (Senate Bill 293, Sen. Rand)

AN ACT TO PERMIT THE IMPORTATION AND BOTTLING OF SPIRITUOUS LIQUOR WITHIN FOREIGN TRADE ZONES LOCATED AT THE WILMINGTON AND MOREHEAD CITY PORTS.

This act creates a new type of commercial ABC permit known as a liquor importer/bottler permit. The application fee for this permit is $250.00. The fee is collected by the ABC Commission and remitted to the State Treasurer for the General Fund. The permit is valid for one year, from May 1 to April 30. G.S. 18B-903 provides that the renewal fee is 25% of the original application fee: $62.50. The holder of a liquor importer/bottler permit would also need to obtain a State license. The annual tax for this license is $250.00. The act became effective upon ratification, July 11, 1995, and will generate a small amount of revenue for the General Fund.

A liquor importer/bottler permit will allow the holder of the permit to import liquor in closed containers into the foreign trade zone at either of the State Ports via ships that dock at the Ports. The imported liquor can be bottled, packaged, or labeled or it can be stored and shipped to State or local ABC warehouses and, where permitted by other jurisdictions, to public and private agencies in those jurisdictions. The liquor can also be transported from the State Ports for purposes related to bottling, packaging, labeling, sale, or storage.

Prior to the enactment of this new permit, State law did not provide a way for liquor to be imported into North Carolina. For imported liquor to be sold in this State, it had to be imported into another State and then be sold to this State. This act will allow a person to purchase liquor in bulk, import it into the State, bottle it, and send it to a warehouse. The permit is similar to the bottler permit the State currently provides for malt beverages, unfortified wine, and fortified wine and to the distillery permit, which allows the holder to import ingredients used in the distillation of spirituous liquor.

1995 Chapter 410 (House Bill 504, Rep. G. Robinson)

AN ACT TO SUBTRACT ANY TRADE-IN ALLOWANCE IN CALCULATING THE ALTERNATIVE HIGHWAY USE TAX ON LEASED VEHICLES.

This act excludes a trade-in allowance from the amount on which the alternate highway use tax on leased vehicles is calculated. The change becomes effective October 1, 1995. The change is expected to reduce Highway Trust Fund revenue by $1 million to $1.5 million a year.

Until October 1, 1995, the highway use tax on leased vehicles will apply to the gross receipts from the lease or rental of the vehicle with no deduction for the value of a trade-in allowance. If, for example, a person leases a vehicle for $250 a month and at the same time trades in a vehicle worth $5,000, highway use tax is due on the monthly payment and on the trade-in allowance of $5,000.

This is in contrast to the way highway use tax is calculated on the sale of a motor vehicle. The sales price of a motor vehicle is reduced by the amount of any allowance given by the seller for a motor vehicle taken in trade as a partial payment for the purchased motor vehicle. If, for example, a person buys a car worth $20,000 and at the same time trades in a vehicle worth $5,000, highway use tax is due on $15,000.

The difference in treatment between sales and leases stems from differences in the highway use tax and the sales tax. As part of the 1989 Highway Trust Fund legislation, motor vehicles were exempted from sales tax and made subject to highway use tax. When vehicles were subject to sales tax, the sales price was not reduced by the amount of a trade-in allowance. The new highway use tax specifically allows a reduction in sales price for the value of a trade-in but does not allow a reduction in the lease price. The highway use tax legislation provides that highway use tax due on the lease of a motor vehicle is to be administered as if it were a sales tax on the motor vehicle. Consequently, the general sales tax rule that the lease price is not reduced by a trade-in allowance applies to the collection of highway use tax on leased vehicles.

The highway use tax is 3% of the retail value of a motor vehicle, subject to both a minimum and a maximum tax. The minimum tax is $40 until July 1, 1996. Beginning July 1, 1996, the minimum tax is repealed. The maximum tax is $1,500 for automobiles and other vehicles that weigh no more than 26,000 pounds and is $1,000 for vehicles that weigh more than 26,000 pounds. When a lessor of vehicles buys a vehicle to be leased, the lessor has the option of either paying highway use tax when the lessor obtains a certificate of title for the vehicle or paying a tax on the gross receipts of the vehicle. If the lessor elects to pay on the gross receipts, the lessor must pay the alternate tax to the Department of Revenue. The alternate tax is 3% on the gross receipts from long term leases and rentals and 8% on the gross receipts from short term leases and rentals. The 8% tax goes to the General Fund and the 3% tax goes to the Highway Trust Fund.

1995 Chapter 443 (Senate Bill 229, Sen. Odom)

AN ACT TO REMOVE IMPEDIMENTS AND DISINCENTIVES TO DONATING CONSERVATION LAND OR PRESERVATION STRUCTURES OR SITES.

This act removes disincentives for donations of conservation or preservation land or property in three ways:

1. It recognizes and ratifies conservation and preservation agreements with the federal government.
2. It amends the Marketable Title Act to prevent conservation and preservation agreements from expiring if not rerecorded.
3. It eliminates the requirement that back property taxes be paid when use value property is donated for conservation or preservation purposes.

Section 1 of this act adds the federal government as a recognized holder of a conservation or preservation agreement under Article 4 of Chapter 121 of the General Statutes, the Conservation and Historic Preservation Agreements Act. That Article permits an owner of real property to include restrictions on property interests transferred to a governmental entity or nonprofit corporation to retain land and water in their natural, scenic, or open condition or in agricultural, horticultural, farming, or forest use. The Article also authorizes restrictions on transferred historical structures to preserve their historically significant architecture, archaeology, or historical associations. This section became effective upon ratification, July 18, 1995, and Section 2 extends it retroactively to June 1, 1979, thereby ratifying conservation and preservation agreements entered into with the federal government since that date.

Section 3 of this act adds an additional exception to the Marketable Title Act for conservation and preservation agreements entered into pursuant to the Conservation and Historic Preservation Agreements Act. The purpose of the Marketable Title Act is to simplify chains of title to real property by extinguishing certain claims against property if the claims are more than 30 years old, unless the claimed interest is rerecorded within the 30-year period. Because of concerns that the renewal dates for conservation and preservation agreements could be overlooked by the government or nonprofit corporation that holds the property interest and because these agreements serve a public purpose, this act provides that they will not be allowed to expire or be terminated as a matter of law by the Marketable Title Act.

Section 4 of this act eliminates the rollback of deferred taxes on transferred use value property if the property is donated to a governmental unit or is donated to a nonprofit organization for use as a protected natural area or for nonprofit historic preservation purposes. Property tax law provides that all property is to be taxed at its market value. A special use value law makes an exception for agricultural land, horticultural land, and forestland: it can be taxed at its value in its current use. The taxes that would otherwise have been due are deferred and become a lien on the land, however. If the property is transferred or otherwise becomes ineligible for use value taxation, three years of these deferred taxes become due and payable to the local government taxing units. This section provides an exception for land the owner donates to governmental units or donates to nonprofits for conservation or preservation. This section, which became effective January 1, 1995, will cause a revenue loss to local governments. The amount of the loss cannot be determined because one cannot predict how much property will be donated each year.

1995 Chapter 451 (House Bill 360, Rep. Black)

AN ACT TO EXEMPT RAILROADS FROM PAYMENT OF SALES TAX ON DIESEL FUEL USED BY LOCOMOTIVES AND RAILROAD CARS.

This act exempts railroad companies from paying the 6% State and local sales tax on diesel fuel used to operate railroad locomotives and railroad cars. Railroad companies do not pay motor fuel tax on diesel fuel used to operate railroad locomotives and railroad cars because the fuel is not used to operate a vehicle on the highways. The motor fuel tax on diesel fuel is 21.95¢ per gallon. This act, introduced on behalf of the Department of Transportation, exempts railroad companies from paying either sales tax or motor fuel tax on diesel fuel. The act is effective September 1, 1995, and is expected to reduce General Fund tax revenues by about $1.5 million a year.

There are many exemptions from the sales and use tax in the current law. An existing exemption, similar to the railroad diesel exemption added by this act, is the sale of fuel used by ocean-going vessels engaged in interstate commerce.

1995 Chapter 454 (Senate Bill 237, Sen. Speed)

AN ACT TO CLARIFY THE USE VALUE TAX LAW, TO UPDATE THE LAW TO CONFORM TO MODERN FAMILY PROPERTY TRANSACTIONS, AND TO EXPAND THE CATEGORY OF PERSONS WHO MAY QUALIFY FOR USE VALUE PROPERTY TRANSFERS.

This act makes several changes to the special property tax classification for farm property taxed at its use value rather than its market value. It clarifies the kinds of individual owners who can qualify for this classification, allows farmland owned by a partnership, a trust, or a limited liability company to qualify for use value tax treatment to the same extent as a corporation, allows farmland owned by certain trusts to qualify for use value tax treatment, and expands the definition of "relative" used to determine qualification for use value tax treatment. The changes became effective January 1, 1995, and apply to tax years beginning with the 1995-96 tax year. The changes are not expected to have a significant impact on local property tax revenues, but will reduce revenue to a slight extent.

Property tax law provides that unless property is exempted or classified for special tax treatment, it is to be taxed at its market value. Agricultural land, horticultural land, and forestland are classified and are taxed at their value in their present use as agricultural land, horticultural land, or forestland. The difference between the taxes due on the present use value treatment and the taxes that would have been payable in the absence of this special treatment, together with any interest, penalties, or costs, are a lien on the property. The difference in taxes is carried forward in the records of the taxing unit as deferred taxes. The deferred taxes for the preceding three years become payable whenever the property is sold or whenever the property loses its eligibility for the benefit of the special use value law.

To qualify for use value taxation, the property must meet minimum size requirements, must be in actual production, must be owned by an individual or by a corporation whose principal business is cultivating the land and whose shareholders are all either actively engaged in this business or are relatives of a member who is actively engaged in this business. Agricultural land and horticultural land must also produce gross income that meets minimum thresholds.

Before the enactment of this act, the term "individually owned" had been interpreted administratively to include an individual who is a beneficiary of a trust, a partner in a

partnership, or a member of a limited liability company. Under this interpretation, these individuals could qualify their share of the land as if they owned it directly. The act codifies this interpretation of the law by modifying the definition of "individually owned" to specifically include these individuals and to clarify how an undivided interest is identified.

The act expands the special use value law to allow partnerships and limited liability companies to qualify their property for use value if they meet the conditions set for corporations. These conditions are that the principal business of the entity is cultivating the land, that the partners or members are all actively engaged in this business or are relatives of someone who is actively engaged in this business, and that the entity or a partner or member of the entity owned the land for the previous four years.

The act further expands the special use value law to allow three types of trusts to qualify. The first type is a trust that is created by an individual and whose beneficiaries are all either the creator of the trust or a relative of the creator. The second type is an extension of the first type; it is a trust that is created by an individual and whose beneficiary is a trust whose beneficiaries are all either the creator of the initial trust or a relative of the creator. The third type is a testamentary trust created by an individual who owned land that was taxed at its use value, transferred the land to the trust upon death, had no relatives at the time of death, and designated that all trust income be used exclusively for nonprofit purposes. For any of these trusts to qualify, the trust or the creator of the trust had to own the land for the previous four years.

Finally, the act expands the definition of "relative" to include nieces and nephews and their descendants, aunts and uncles, parents-in-law, stepchildren and their descendants, and the spouse of any of these relatives. The definition of "relative" in the current law does not include these relatives.

1995 Chapter 456 (House Bill 718, Rep. Gray)

AN ACT TO ESTABLISH A NORTH CAROLINA PARKS AND RECREATION AUTHORITY AND TO EARMARK FUNDS FOR THE PARKS AND RECREATION TRUST FUND AND THE NATURAL HERITAGE TRUST FUND.

This act reallocates the State's share of the deed stamp tax to the Parks and Recreation Trust Fund and the Natural Heritage Trust Fund, modifies the purposes for which the Parks and Recreation Trust Fund may be used, and creates the North Carolina Parks and Recreation Authority to administer the Parks and Recreation Trust Fund. These changes become effective July 1, 1996.

Under current law, 15% of the State's share of the deed stamp tax ($3.1 million) each year is dedicated to the Natural Heritage Trust Fund created in G.S. 113-77.7 and the remaining 85% ($18 million) goes to the General Fund. Chapter 772 of the 1993 Session Laws declared that it was the intent of the General Assembly to dedicate 75% of the State's share of the deed stamp tax each year to the Parks and Recreation Trust Fund and an additional 10% to the Natural Heritage Trust Fund. Section 3 of this act fulfills that intent by dedicating 75% of the State's share ($15.9 million) to the Parks and Recreation Trust Fund and 25% ($5.3 million) to the Natural Heritage Trust Fund. These funds will be transferred on a quarterly basis each year beginning July 1, 1996. None of the State's share of the deed stamp tax will go to the General Fund after that date.

The deed stamp tax is an excise tax on instruments transferring real property. It is collected by the register of deeds of the county in which the property is located and is collected when the deed transferring the property is recorded. The tax rate is $1.00 for each $500.00 (0.2%) of the value of the property conveyed. Each county must remit one-half of the net proceeds of the tax to the Department of Revenue. The requirement that each county send one-half of the tax to the State was enacted in 1991 when the State doubled the tax rate from 50¢ to $1.00 for each $500.00 of value.

Section 2 of this act modifies the use of revenue in the Parks and Recreation Trust Fund. It decreases the amount of the Fund that is to be used for the State Parks system from 75% to 65% and increases the amount that is to be used for local matching grants for local parks and recreation from 20% to 30%. In addition, it allows the use of up to 3% of the Fund each year for operating expenses associated with managing capital improvements, acquiring land, and administering local grants.

The remainder of this act creates the North Carolina Parks and Recreation Authority within the Department of Environment, Health, and Natural Resources. The Authority will administer the Parks and Recreation Trust Fund and report annually to the General Assembly on allocations from that Trust Fund. The Authority will also advise the Secretary of Environment, Health, and Natural Resources. The existing Parks and Recreation Council, an advisory council within the Department of Environment, Health, and Natural Resources, is repealed. The Authority will have nine members; the Governor, the Speaker of the House of Representatives, and the President Pro Tempore of the Senate will each select three. Members will serve staggered two-year terms.

1995 Chapter 458 (Senate Bill 606, Sen. Sherron)

AN ACT TO PROVIDE FOR THE CREATION OF FACILITY AUTHORITIES AND TO ESTABLISH THE CENTENNIAL AUTHORITY.

This act provides the statutory framework for the General Assembly to create a "facility authority" and, in conjunction with that framework, establishes a Centennial Authority in Wake County. The purpose of a facility authority is to study, design, plan, construct, own, promote, finance, and operate a regional facility. A regional facility is a facility designed to attract major regional, national, and international sports and recreational events. The act became effective upon ratification.

A facility authority will have either eight or 13 members, depending on the territorial jurisdiction of the authority. The initial eight members are appointed by the General Assembly. The territorial jurisdiction of an authority is the county in which the regional facility is to be located. If the jurisdiction of an authority is a county where the main campus of a constituent institution of The University of North Carolina is located, then the authority will have 13 members. Of the additional five members, two are appointed by the board of county commissioners, two are appointed by the city council of the city with the largest population in the county, and the remaining member is appointed jointly by the mayors of all the cities in the county. A member may be removed by the appointing authority for cause and a vacancy occurring in the membership will be filled by the remaining members.

An authority has the power to issue bonds, approved by the Local Government Commission. The bonds may be secured by the revenues of the regional facility, by security interests in real or personal property, including a leasehold interest, acquired or improved with the proceeds of the bonds, and, with the approval of the county levying the tax, by the receipts

of a room occupancy and prepared food and beverage tax levied by the county. A pledge of a county's room occupancy and prepared food and beverage tax does not restrict the county's right to repeal the tax. The faith and credit of the State or a political subdivision of the State may be pledged as security for bonds.

An authority has the power to contract with any public entity. Also, The University of North Carolina or any constituent institution of The University of North Carolina may enter into a contract with an authority if the function is one The University of North Carolina could undertake separately. If a regional facility is used to host an athletic event sponsored by a constituent institution of The University of North Carolina whose principal campus is located in the territorial jurisdiction of the authority, then at least 50% of the seats for the event must be made available to students at that institution and to members of the general public. The act also amends the ABC laws to allow the sale of beer and unfortified wine at a regional facility unless the events being hosted are high school or college functions.

After setting forth the statutory framework for facility authorities, the act specifically creates one in Wake County, to be known as the Centennial Authority. The act authorizes the Director of the Budget to allocate any funds which have been appropriated to the Centennial Authority, but not yet expended or obligated, to the Centennial Authority. The act also amends the Wake County room occupancy and prepared food and beverage tax law to require some distribution of revenue to the Centennial Authority.

Under the new distribution of tax proceeds, Wake County and the City of Raleigh must jointly transfer $11 million to the Centennial Authority by June 30, 1996, and an additional $11 million by June 30, 1997. This money may be used by the Authority only to fund all or part of the acquisition, construction, financing, and debt servicing of a regional facility to be located in the general vicinity of the Carter-Finley stadium. The act also directs Wake County and the City of Raleigh to transfer 7% of the total undesignated proceeds distributed to them to the Centennial Authority by July 1 of each year, beginning July 1, 1995. This money may be used only for enhancement of operating revenues of a regional facility and for planning, design, renovations, maintenance, and repairs to a regional facility. "Undesignated proceeds" are all tax proceeds distributed to Wake County and to Raleigh other than annual distributions to Raleigh of $680,000 of room tax proceeds and $680,000 of meals tax proceeds.

1995 Chapter 459 (Senate Bill 1055, Sen. Kerr)

AN ACT TO MODIFY THE EXCISE TAX ON NEWSPRINT.

This act amends the excise tax on newsprint that was enacted in 1991. The purpose of the tax is to encourage the use of recycled newsprint by imposing a privilege license tax on those who produce publications printed on newsprint and do not use a minimum amount of recycled paper. The tax became effective October 1, 1991, and is payable quarterly. The tax rate is $15.00 for each ton of newsprint that is consumed during a reporting period and has an average recycled content percentage that is less than the required minimum recycled content percentage. The proceeds of the tax are earmarked for the Solid Waste Management Trust Fund created under G.S. 130A-309.12.

Under the law, a publisher must pay the tax unless the recycled content percentage of the newsprint consumed by the publisher equals or exceeds stated percentages. Under the original legislation, the percentage of required recycled content of the newsprint consumed gradually increased from 12% in 1991 to 40% in 1997. This act eases the burden on publishers to meet these purchasing percentage goals in two ways:

1. It extends the period of time a publisher has to reach the goal of using newsprint with at least 40% recycled content. Under this act, the percentage increase from 25%, which is the current percentage rate, to 40% would be extended by 3 years to the year 2000.
2. It creates a credit that can be used towards the recycled content percentage goals, for publishers who develop and operate or contract for the operation of a newspaper recycling program. A publisher would receive one-half ton credit toward its total recycled content tonnage for each ton of recycling tonnage.

The act also makes a few less substantive changes:

1. It eliminates the need for filing a quarterly return and substitutes the use of an annual return. To conform with this change, the act directs the Secretary of Revenue to credit the tax proceeds to the Solid Waste Management Trust Fund on or before April 15 of each year.
2. It changes the term "producer" to "publisher".
3. It changes the basis for determining the recycled content percentage to gross tonnage of newsprint consumed, instead of net tonnage. The act also clarifies how this calculation is made.

The tax does not apply in a few circumstances. It does not apply to newsprint that is acquired by a publisher and then recycled by the publisher. It also does not apply if the publisher of a publication could not meet the required minimum recycled content standards for one or more of several reasons. The reasons are an inability to obtain newsprint made from recycled paper at a price or quality comparable to other newsprint, in an amount needed for a publication, or in a reasonable amount of time. A publisher who claims an exemption for one of these reasons must document the publisher's effort to obtain newsprint that contained the required minimum percentage of recycled paper.

1995 Chapter 461 (House Bill 1060, Rep. McComas)

AN ACT AMENDING THE GENERAL STATUTES RELATING TO THE CONSOLIDATION OF CITIES AND COUNTIES AND CONSOLIDATED CITY-COUNTY TAXATION AND FINANCE.

This act modifies the law relating to consolidated city-counties, effective July 19, 1995. Article 20 of Chapter 153A of the General Statutes provides a procedure for a city and a county to form a consolidation study commission to adopt a plan of consolidation and to hold a referendum on the consolidation. The consolidation of a city and a county must be enacted by the General Assembly, however, before it can become effective.

Chapter 160B of the General Statutes, the Consolidated City-County Act of 1973, governs consolidated city-counties. A consolidated city-county is a county in which the largest municipality has been abolished and its powers, duties, rights, privileges, and immunities have been consolidated with those of the county. Other municipalities may also be abolished and consolidated with the county. A consolidated city-county may define urban service districts to finance services within the county at a higher level than in other areas of the county. These urban service districts may replace municipalities that have been abolished or may be created to serve areas that have population density, property valuation, and needs that justify a higher level of services than is provided in the county generally. The consolidated city-county may levy property taxes, motor vehicle taxes, and privilege license taxes within an urban service district to finance additional services within the district.

Sections 1 and 2 of this act amend Chapter 160B of the General Statutes to clarify the powers and governance of a consolidated city-county. A consolidated city-county has the same powers, duties, rights, etc., as a county throughout its jurisdiction and as a city within its urban service districts. To the extent a city can exercise powers, duties, rights, etc., outside its boundaries, a consolidated city-county can exercise those powers, duties, rights, etc., outside the boundaries of its urban service districts. The powers, duties, rights, etc., of an urban service district are exercised by the governing body of the consolidated city-county and debts owed an urban service district are payable to the governing body of the consolidated city-county.

This act makes other miscellaneous changes relating to consolidated city-counties. Section 1 provides a procedure for a consolidated city-county to study dissolution and prepare a plan of dissolution. Section 2 provides that, before the effective date of a consolidation, an interim governing board of a proposed consolidated city-county may define an urban service district, which will take effect on the effective date of the consolidation. Sections 2 and 3 provide that a plan for consolidation may include proposed urban service districts and, if the planned consolidation goes into effect, no additional notice is required of the proposed district. Sections 6 - 18 make conforming and technical changes to various statutes relating to taxation, water sewer districts, solid waste, and local government fiscal control to clarify the status of a consolidated city-county.

Sections 4 and 5 make changes that apply only to New Hanover County. In order to comply with the State constitutional requirement in Section 4(1) of Article V that only general, not local, laws may be enacted relating to local government debt, these provisions are made applicable only to a class that includes counties with a population over 120,000 and a land area less than 200 square miles. New Hanover County is the only county in this class. Sections 4 and 5 provide that a consolidation cannot become effective unless the voters of the county have approved the assumption of the city's debt. These sections provide a procedure for the referendum, requirements for assumption of debt and notification, and limitations on actions to contest consolidations.

1995 Chapter 463 (Senate Bill 180, Senator Shaw)

AN ACT TO MODIFY THE PAYMENT AND REPORTING REQUIREMENTS AND THE COLLECTION PROCEDURES FOR UNEMPLOYMENT CONTRIBUTIONS AND TO PROVIDE FOR A REDUCTION IN THESE CONTRIBUTIONS IN CERTAIN CIRCUMSTANCES.

This act makes the following changes in the payment and collection of unemployment contributions:

1. It increases the minimum payment threshold from $1 to $5. A person is not required to make unemployment contributions if the amount owed is less than the minimum payment threshold. This change becomes effective September 30, 1995.
2. It increases the unemployment contribution refund threshold from $1 to $5. If a person overpays unemployment contributions by less than the refund threshold, the Employment Security Commission will refund the overpayment only if the person who made the overpayment asks for a refund in writing. This change becomes effective September 30, 1995.
3. It gives the Employment Security Commission the authority to allow certain small employers to file an annual report rather than quarterly reports and to file the annual report by telephone. The small employers that can be allowed to do this are

those that have filed reports with the Commission for at least the past three years and have not been liable for quarterly contributions for the past year.

For those allowed to make annual reports, the report is due by January 31 of each year. The authority to make an annual report is revoked if the employer becomes liable for contributions or if certain information on the employer's last report changes. To ensure that the Commission has timely employee and wage information, employers filing annual reports must report changes in employment status and wages to the Commission within 14 days and must respond to inquiries from the Commission within 14 days. This change becomes effective September 30, 1995.

4. It establishes another automatic reduction in unemployment contributions for employers with positive ratings in one circumstance. That circumstance is when the Unemployment Insurance Fund has a balance of at least $800,000,000 and the Unemployment Insurance Fund ratio is at least 5%. The Unemployment Insurance Fund ratio is determined by dividing the amount in the Fund by the State taxable wage base. The current ratio is 4.6% and is not expected to reach or exceed 5% in the next five years. If the fund ratio does reach 5%, the taxes of employers with positive ratings will be reduced by 60% rather than 50%. This change becomes effective for quarters beginning on or after March 31, 1996.
5. It requires a representative of the Employment Security Commission to attempt to contact a person who owes less than $50 in delinquent unemployment contributions before the Commission obtains a judgment lien for the delinquent amount. This change becomes effective upon ratification.
6. It eliminates the imposition of a $5 late filing penalty for employers who file a return within 30 days after the due date and owe no tax with the return. This change becomes effective upon ratification.
7. It removes the current 24-month restriction on waiving penalties. This restriction prohibited the Commission from waiving penalties against the same employer more than once in a 24-month period. Under the act, there is no limit on the number of times a penalty can be waived against the same employer in any time period. This change also becomes effective upon ratification.

1995 Chapter 465 (Senate Bill 407, Sen. Perdue)

AN ACT TO EXEMPT TRAILERS FROM THE PAYMENT OF THE GLOBAL TRANSPARK TEMPORARY ZONE VEHICLE REGISTRATION TAX.

This act exempts trailers from the annual $5 vehicle registration tax imposed in the counties in the Global TransPark Development Zone. The counties in the TransPark Zone are Carteret, Craven, Duplin, Edgecombe, Greene, Jones, Lenoir, Nash, Onslow, Pamlico, Pitt, Wayne, and Wilson counties. The exemption becomes effective October 1, 1995. The exemption is expected to reduce annual revenue for the TransPark Zone by approximately $330,000.

The $5 tax is in addition to the regular vehicle registration fee. When the additional $5 tax was imposed on July 1, 1994, it applied to all trucks, all trailers except mobile homes, and all passenger vehicles registered in a county in the TransPark Zone. When this act becomes

effective, the tax will no longer apply to trailers. The regular annual registration fee for a trailer is 10.00.

The vehicle registration tax levied by the Zone is a temporary tax that will expire 5 years after the effective date of the first tax levy, which was July 1, 1994. The Division of Motor Vehicles collects and administers the tax at the same time and in the same manner that it administers the annual vehicle registration fees.

The Commissioner of Motor Vehicles credits the proceeds of the $5.00 temporary Zone vehicle registration tax to a special account. The interest on the special account is credited quarterly to the Highway Fund to reimburse the Division for the cost of collecting and administering the tax. The Zone must place 15% of the tax proceeds distributed to it in a general funds account and the remaining 85% in an interest-bearing trust account. The Zone may not disburse the principal of the trust account except pursuant to a contract that provides that the Zone will recover or be repaid the amount disbursed within a reasonable period of time, not to exceed 20 years. Each county that is a member of the Zone is the beneficial owner of a share of the principal of the trust account in proportion to the amount of tax proceeds collected in that county.

The enactment of this act makes the vehicle base for the Triangle Transit Authority different from the vehicle base for the Global TransPark. The $5 vehicle registration tax imposed by the Triangle Transit Authority applies to trailers.

1995 Chapter 468 (Senate Bill 121, Sen. Kerr)

AN ACT TO REVISE THE PROCEDURES FOR ASSESSMENTS OF INHERITANCE TAX FOLLOWING A FEDERAL DETERMINATION.

This act makes the time limits for assessing any inheritance tax due after a federal determination of the value of an estate the same as the time limits that apply to assessments of other state taxes following a federal determination. The act became effective August 1, 1995. The original bill, recommended by the Revenue Laws Study Committee, would also have reduced inheritance and gift taxes in a number of ways.

The act makes the same changes for inheritance tax that were made for gift tax, income tax, and withholding tax by Chapter 582 of the 1993 Session Laws: it revises the procedures for assessments of inheritance tax following a federal determination of federal estate tax to match those that apply to gift tax, income tax, and withholding tax. The revision makes the following substantive changes:

1. It extends from 30 days to two years the period of time in which a taxpayer must file an amended inheritance tax return following a federal determination.
2. It gives the State an additional one-year or three-year period to make an assessment of inheritance tax following a federal determination.
3. It reduces the penalty for failure to file an amended return following a federal determination from 25% of the amount of any additional tax due, with a minimum of $25 and a maximum of $500, to 5% of the amount of tax due, with an additional 5% for each month the tax is overdue.
4. It denies a refund that would otherwise be due if an amended return is not filed after a federal determination.

A federal determination is a report by the Internal Revenue Service (IRS) that a taxpayer has not filed a return or has filed an incorrect return and, therefore, either owes more taxes or is entitled to a refund. If a taxpayer did not file a return or understated the amount due on a return, the determination states the amount of tax the IRS finds is due and serves as the federal notice of assessment. The IRS eventually sends the appropriate state a copy of the federal determination. A delay between when a taxpayer receives a federal determination and when a state receives a copy of the determination occurs when the taxpayer is in the process of resolving with the IRS questions raised by the determination.

Under the State income, gift, and withholding tax laws, a taxpayer who receives a federal determination of federal income, gift, or withholding tax must, within two years, file the appropriate amended State return with the Department of Revenue reflecting the determination. Under these taxes, if a taxpayer files an amended return in response to a federal determination, the Department of Revenue has one year from the date it receives the return to make an assessment of State income, gift, or withholding taxes. If a taxpayer does not file an amended return in response to a federal determination, the Department of Revenue has three years from the date it receives a copy of the determination from the IRS to make an assessment.

The general limitations period for an assessment of any State tax is three years after a return was filed or due to be filed. The one-year and three-year periods following a federal determination are in addition to the regular three-year period, which is set out in G.S. 105-241.1. An additional time period is necessary when a federal determination is made in order to allow the State adequate time to respond to the federal determination. The State might not receive an amended return following a federal determination or a notice of a federal determination from the IRS until near the end of or after the end of the general three-year period.

Unlike the income, gift, and withholding tax laws, the inheritance tax laws, prior to the enactment of this act, did not give the State any additional time to make an assessment following a federal determination. Therefore, for an assessment of inheritance tax, the State had to make an assessment within the general three-year time period for making assessments. When the State did not receive notice of a federal determination of estate taxes until near the end of or after the end of this three-year period, the State was foreclosed from making an assessment.

1995 Chapter 472 (House Bill 759, Rep. Gray)

AN ACT TO PROVIDE THAT A HOME FOR THE AGED, SICK, OR INFIRM WHOSE PROPERTY IS EXEMPT FROM PROPERTY TAX IS ALLOWED A REFUND OF STATE AND LOCAL SALES AND USE TAXES.

This act allows certain nonprofit homes for the aged, sick, or infirm to obtain semiannual refunds of State and local sales and use taxes paid by the homes. The act became effective upon ratification and applies retroactively to purchases made on or after January 1, 1995. The refunds are expected to reduce General Fund revenue by approximately $1.5 million a year and reduce local government revenues by approximately $.7 million a year.

The homes covered by the act are those whose property is exempt from property taxes under G.S. 105-275(32). That provision exempts the property of church-related and Masonic continuing care retirement homes from property tax. The homes that qualify are nonprofit self-contained communities that meet the following qualifications:

1. Are designed for elderly residents.
2. Operate a skilled nursing facility, an intermediate care facility, or a home for the aged.
3. Include residential dwelling units, recreational facilities, and service facilities.
4. Have a charter that provides that in the event of dissolution, the assets of the home will revert or be conveyed to a nonprofit entity.
5. Are managed by a church or other religious body or a Masonic group.
6. Have an active program to generate funds through one or more sources, such as gifts, grants, trusts, bequests, an endowment, or an annual giving program, to assist the home in serving persons who might not be able to reside at the home without financial assistance or subsidy.

In exempting these homes from sales and use taxes, the act resolves lingering issues from a 1984 property tax case. Before 1984, the Department of Revenue allowed sales and use tax refunds to these homes as nonprofit charitable or religious institutions. In 1984, the Court of Appeals upheld a decision of the Property Tax Commission denying a property tax exemption to Lutheran Home Ministries on the basis that it was not a charitable institution. The General Assembly responded to the court's ruling by granting these homes a property tax exemption in 1987 under G.S. 105-275(32).

The Department of Revenue applied the court's reasoning to sales and use taxes and denied sales and use tax refunds to some of these homes beginning in 1984. Because the 1987 legislation did not change the sales and use tax laws, the Department continued to deny refunds to some of these homes based upon the 1984 Court of Appeals decision. This act clarifies that homes that are exempt from property tax as charitable institutions are also entitled to a refund of sales and use taxes. The General Assembly ratified this act on July 25, 1995. Subsequently, on August 1, 1995, the Court of Appeals issued a decision finding that these homes are entitled to a refund of sales and use taxes. The case before the court concerned whether or not Southminster, Inc. and Davidson Retirement Community, Inc. were charitable organizations and as such were entitled to a semiannual refund of sales and use taxes. The court found that the two institutions were charitable organizations, based partially on the fact that they are considered charitable organizations for property tax purposes under G.S. 105-275(32).

1995 Chapter 474 (House Bill 223, Rep. Gray)

AN ACT TO REDUCE THE EXCISE TAX ON SOFT DRINKS.

This act reduces the State excise tax on soft drinks by 25% effective July 1, 1996. It does not phase out the soft drink tax, as did the original version of House Bill 223.

The act reduces the excise tax on bottled soft drinks from 1¢ a bottle to 3/4¢ a bottle, reduces the excise tax on liquid base products from $1.00 a gallon to 75¢ a gallon, and reduces the excise tax on dry base products from 1¢ an ounce to 3/4¢ an ounce. It preserves the current 1/2 rate of tax on the first 15,000 gross of bottled soft drinks sold each year by a distributor. The act is expected to reduce soft drink tax revenue by $9.6 million in fiscal year 1996-97 and $10.1 million in 1997-98.

The soft drink excise tax was enacted in 1969. The purpose of the tax is to provide an additional source of revenue to the General Fund. In fiscal year 1993-94, the soft drink excise

tax accounted for $36,538,688 of the General Fund tax collections. A soft drink is defined as a beverage that is not an alcoholic beverage. The following items are exempt from the tax:

1. Natural liquid milk drink produced by a farmer or a dairy.
2. A bottled soft drink that contains at least 35% natural milk.
3. Natural juice.
4. Juice that would be natural if it did not contain sugar.
5. Natural water.
6. A base product used to make a bottled soft drink subject to tax under this Article.
7. Coffee or tea in any form.
8. A bottled soft drink or base product sold outside the State.
9. A bottled soft drink or base product sold to the federal government.
10. A base product for home use that either contains milk or requires milk to be added to make a soft drink.

The soft drink excise tax is payable by the person who is the first to bring the product into the State. The soft drink excise tax has a bifurcated tax rate system. The purpose of the bifurcated tax system is to tax the sale or distribution of the soft drink itself when practical, but to tax the sale or distribution of the ingredients of the soft drink when the taxation of the product itself is not practical.

1995 Chapter 477 (House Bill 55, Rep. Redwine)

AN ACT TO PROVIDE THAT SALES TAX PREFERENCES FOR AGRICULTURE APPLY TO AQUACULTURE.

This act clarifies the application of two sales and use tax agricultural preferences to farmers who raise fish or water plants and expands a current agricultural sales and use tax exemption to include this type of farmer. The act became effective August 1, 1995. The act is projected to reduce annual State sales and use tax collections by less than $50,000 and to reduce annual local sales and use tax collections by less than $25,000. The act was recommended by the Joint Legislative Commission on Seafood and Aquaculture.

A sales and use tax preference is the exemption of an item from sales and use tax or the taxation of an item at less than the regular 6% combined State and local rate. The two sales and use tax preferences the act clarifies are the taxation of certain items at the rate of 1% with an $80 cap and the exemption of certain items used in agriculture.

Section 1 of the act makes it clear that machines and machine parts sold to a farmer for use in raising an aquatic species are taxable at the State rate of 1% with an $80 cap rather than at the full State and local 6% rate. An aquatic species is any species of finfish, mollusk, crustacean, or other aquatic invertebrate, amphibian, reptile, or aquatic plant. The Department of Revenue has construed "farm crops" in this category to include aquatic species. The act therefore clarifies the application of this reduced rate to fish farmers rather than include them in the reduced rate for the first time.

Section 2 of the act makes it clear that the agricultural exemptions in G.S. 105-164.13(2) apply to aquatic species farmers and that all the exemptions in this subdivision,

other than the one for seeds, are limited to commercial production. It does this by changing references to "livestock and poultry" to "animals," by changing references to "agriculture" to the "commercial production of plants or animals," and by inserting a statement that the items must be for commercial use. The exemptions are for medicine, litter material, feed, pesticides and similar products, defoliants, and plant growth regulators.

The Department of Revenue has construed "livestock" in the exemptions in G.S. 105-164.13(2) to include fish and has for many years interpreted the exemptions for all items in this subdivision, other than seeds, to apply to commercial use only. The act therefore clarifies these exemptions and their application to aquaculture.

In addition to clarifying these two sales and use tax preferences, the act expands the agricultural exemption in G.S. 105-164.13(4c) for certain kinds of facilities and equipment to include fish facilities and equipment. Prior law exempted facilities for commercial use in housing, raising, or feeding swine, livestock, or poultry, equipment used in these facilities, and building materials used to construct these facilities. "Livestock" under this exemption had not been interpreted to include fish. Section 3 of the act expands this exemption to include fish by deleting references to "swine, livestock, and poultry" and referring instead to "animals." This exemption applies to both State and local sales and use taxes

1995 Chapter 491 (Senate Bill 1049, Sen. Sherron)

AN ACT TO CLARIFY THE QUALIFIED BUSINESS TAX CREDIT TO ELIMINATE AN UNINTENDED LOOPHOLE THAT ALLOWS DOUBLE CREDITS FOR THE SAME INVESTMENT AND TO AUTHORIZE THE LEGISLATIVE RESEARCH COMMISSION TO STUDY THE QUALIFIED BUSINESS TAX CREDIT.

This act addresses a loophole in the Qualified Business Investment tax credit by prohibiting an investor from receiving two tax credits on the same investment. The act also authorizes the Legislative Research Commission to study the tax credit.

In 1987, the General Assembly enacted the Qualified Business Investment tax credit to allow tax credits to individuals and corporations that invest in qualified North Carolina businesses registered with the Secretary of State or in North Carolina Enterprise Corporations. The amount of the credit allowed is 25% of the amount invested, up to a maximum credit of $50,000 for individuals and $750,000 for corporations. If the allowable credit exceeds the taxpayer's tax liability, the excess may be carried forward for five years. The total amount of tax credits that can be granted in any tax year is capped at $12 million. The investors apply for the credit through an application filed with the Department of Revenue by April 15; the Department then determines whether the $12 million cap has been exceeded and, if so, proportionally reduces the amount of each credit applied for.

In 1993, the General Assembly enacted legislation to allow a pass-through entity to qualify for the credit and pass it on to the entity's owners. A pass-through entity is an entity, such as a partnership, a limited liability company, or a Subchapter S corporation, that is treated as owned by individuals or other entities under federal tax law and whose income, losses, and credits are reported by the owners on their State income tax returns.

The law allowing pass-through entities to qualify for this credit became effective with the 1994 tax year. A problem arose because an investor could invest money in a pass-through entity that is itself a qualified business. The investor would receive a 25% tax credit for this investment and, if the pass-through entity then invests in another qualified business, the original

investor would receive a second 25% tax credit, via the pass-through entity, based upon the original financial investment. Section 1 of this act, recommended by the Secretary of State, eliminates this problem by prohibiting a pass-through entity that is also a qualified business from passing the tax credit through to its owners. Therefore, the investor's initial investment in the pass-through entity will qualify for the 25% tax credit but the entity's subsequent investment in another qualified business will not qualify for an additional tax credit for the original investor.

Section 1 will have an unknown effect on General Fund revenues. This section became effective beginning with the 1995 tax year; in order to protect investments made in reliance on the current law, it does not apply to investments and commitments to invest made before August 1, 1995.

Section 2 of the act authorizes the Legislative Research Commission to study the Qualified Business Investment tax credit, in particular to consider how the law can be modified to better encourage venture capital investment in North Carolina. The Commission may make an interim report to the 1996 Session and must make a final report to the 1997 General Assembly.

1995 Chapter 495 (House Bill 396, Rep. McComas)

AN ACT TO MODIFY THE STATE PORTS TAX CREDIT BY EXPANDING IT TO INCLUDE IMPORTS, BY EXTENDING THE SUNSET ON THE CREDIT, AND BY LIMITING THE CREDIT FOR BULK EXPORTS.

This act modifies the income tax credit allowed for amounts assessed by the State ports in three ways. The act was an agency bill requested by the State Ports Authority. The modifications, outlined below, became effective for taxable years beginning on or after January 1, 1995:

1. It expands the credit to include imports; the current credit applies only to exports. The act allows a credit for break-bulk cargo and container cargo imported at either Wilmington or Morehead City and for bulk cargo imported at Morehead City. The act does not allow a credit for bulk cargo imported at Wilmington.
2. It limits the credit for bulk exports to bulk exports at the Morehead City terminal. The current export credit applies to bulk exports at Wilmington as well as at Morehead City.
3. It extends the sunset on the credit for two years. Under prior law, the credit would have expired for taxable years ending on or before February 28, 1996. Under this act, the credit will expire for taxable years ending on or before February 28, 1998.

The State ports income tax credit was enacted in 1992 and expanded in 1994. It was enacted to encourage exporters to use the two State-owned port terminals, which are at Wilmington and Morehead City. When enacted, the credit applied to amounts paid by a taxpayer on cargo exported at either port. The General Assembly expanded the credit in 1994 to include all amounts assessed on exported cargo, regardless of who paid the shipping costs.

The amount of credit allowed is equal to the amount of charges assessed on a taxpayer's cargo that exceeds the average amount assessed on the taxpayer's cargo during the three-year period that includes the current taxable year and the previous two taxable years. The credit may not exceed 50% of the amount of income tax owed by the taxpayer for the

taxable year. Any excess credit may be carried forward and applied to the taxpayer's income tax liability for the next five years. The cumulative credit allowed to the same taxpayer may not exceed $1 million.

1995 Chapter 510 (Senate Bill 693, Sen. Kerr)

AN ACT TO MAKE TECHNICAL AMENDMENTS TO IMPROVE THE ADMINISTRATION OF THE PROPERTY TAX ON MOTOR VEHICLES.

This act makes various technical changes to the statutes concerning the property tax on motor vehicles. The changes are effective for taxes imposed for taxable years beginning on or after July 1, 1995. The changes were suggested by a committee of assessors, collectors, and finance officers as amendments that would improve the administration of the tax. The act has no fiscal effect.

In 1991, the General Assembly created a new procedure for collecting property taxes on motor vehicles that are registered with the Division of Motor Vehicles. Under the system, the registration of a motor vehicle with the Division of Motor Vehicles is considered a listing of the vehicle for property tax purposes and the taxes payable on the vehicle are due four months after the registration is obtained or renewed. If the taxes are not paid within four months after they become due, the Division of Motor Vehicles will refuse to renew the vehicle's registration the following year unless the taxpayer obtains a receipt showing that the previous year's taxes have been paid.

The amendments to the motor vehicle property tax statutes are as follows:

Section	Explanation
1.	The changes in subsection (a) of G.S. 105-330.2 eliminate the problem of the correct evaluation date when an owner with a registration that expires December 31 renews during the January grace period. Under the amendment, the value of the vehicle is determined as of January 1 preceding the date the current registration expires. The ownership, situs, and taxability of the vehicle are determined on the actual day the current registration is renewed. The change in subsection (b) deletes taxability and situs from the requirement that appeals must be taken within 30 days of the date of the notice. Because of incorrect information in DMV records, many situs appeals must be handled more than 30 days after the date of the notice. Under the amended statutes, appeals of situs and taxability will be handled under G.S. 105-381, which allows a taxpayer to contest the situs and taxability within 6 months of the date of payment or within 5 years after the tax first became due, whichever is later.
2.	The change in subsection (a) of G.S. 105-330.4 establishes a new procedure for prorating taxes on vehicles registered under the annual system. Currently, when a vehicle is first registered under the annual system in a month other than December, no taxes are due on that vehicle until after the registration is renewed. This amendment makes prorated taxes due on that vehicle four months after it is registered. The change in subsection (b) postpones the accrual of interest when, for whatever reason, the tax notice is not prepared until some time after the tax due date for a vehicle. In such a case, the amendment provides that interest will begin to

accrue on the first day of the second month following the date of the notice, rather than on the first day of the first month following the date the taxes were due.

3. A new subsection (a1) is created in G.S. 105-330.5 that establishes a formula for prorating taxes on vehicles registered under the annual system. For example, if a new registration is obtained in July, five months remain in the calendar year, so the taxes on that vehicle would be 5/12 of the full amount. These taxes would be due November 1, four months after the date the vehicle is registered.

   The amendment to subsection (b) requires a county to remit municipal and special district taxes at least once a month rather than the current 30 days after collection. It also requires the county to furnish municipalities and special districts located in it information that will enable them to account for the tax payments remitted to them.

   The amendment to subsection (d) changes the rule concerning the levy year in which a tax is to be included when the notice is prepared after the tax due date. For example, under the current law, if a tax is due June 1 but the notice is prepared in August, the tax must still be included in the previous fiscal year's levy. Under the amendment, the tax would be included in the levy for the current fiscal year.

4. The amendment to subsection (a) of G.S. 105-330.6 establishes a tax year for vehicles registered under the annual system that is based on a January 1 - December 31 calendar year. The addition of this tax year is needed to deal with prorated refunds and releases of prorated taxes due on annual system registrations.

   The amendment to subsection (c) increases the time a taxpayer has to request a refund or release of taxes after surrendering the vehicle's plates from 60 days to 120 days.

1995 Chapter 512 (House Bill 1001, Rep. Allred)

AN ACT TO PROVIDE THAT ANTIQUE AUTOMOBILES SHALL BE VALUED AT NO MORE THAN FIVE HUNDRED DOLLARS FOR PROPERTY TAX PURPOSES AND TO ELIMINATE DOUBLE TAXATION OF A MOTOR VEHICLE WHEN THE OWNER MOVES AWAY AND THEN RETURNS TO THE STATE WITHIN ONE YEAR.

This act combines two bills that were considered by the General Assembly this session. The original bill, House Bill 1001, reduces the amount of property tax collectors of antique vehicles must pay by limiting their value to no more than $500 for property tax purposes. The Senate amended the bill to include the contents of Senate Bill 170, which eliminates the highway use tax on a motor vehicle when the owner moves away and then returns to the State within one year. The first part of the act will result in an annual local government revenue loss of less than $700,000. The second part of the act will result in a maximum annual loss to the Highway Trust Fund of approximately $15,000.

Antique automobiles

Under this act, antique automobiles owned by collectors will be effectively exempt from property tax, effective for taxable years beginning on or after October 1, 1995. A vehicle qualifies for this exemption if it meets all of the following conditions:

1. It is registered with the Division of Motor Vehicles and has an historic vehicle special license plate. To qualify for an historic vehicle special license plate, a vehicle must be 35 years old from the date of manufacture. The annual license plate fee for an historic vehicle special license plate is the regular license fee plus an additional $10.00.
2. It is maintained for use in exhibitions, club activities, parades, and other functions of public interest.
3. It is used only occasionally for other purposes.
4. It is owned by an individual.
5. It is used by the owner for a purpose other than the production of income and is not used in connection with a business.

Motor vehicles are designated as a special class of property under G.S. 105-330.1. Vehicles that are registered with the Division of Motor Vehicles are taxed annually as of the day on which the current registration is renewed or the day on which a new registration is applied for. Under Chapter 329, ratified by the General Assembly this session, a local government may adopt a resolution directing the tax collector not to collect property taxes when the amount due is less than $5.00. Few, if any, taxing units have a property tax rate that exceeds $1.00 per $100 of value. Therefore, since the value of the car can not exceed $500 under this act, any unit that adopts a resolution allowing the tax collector to forego collection of property tax bills that are less than $5.00 will effectively eliminate property taxes on antique automobiles owned by collectors.

Personal property that is used by the owner of the property for a purpose other than the production of income and that is not used in connection with a business has been exempt from property taxes since 1987. Personal property includes household furnishing, clothing, pets, and lawn equipment. The term also includes collectibles such as antiques, coins, and paintings. However, the term does not include motor vehicles.

Eliminate double vehicle tax

Effective October 1, 1995, a motor vehicle owner will be allowed a credit against the highway use tax for the amount of highway use tax paid on the same vehicle within the past year. This credit is available only to a person who applies for a certificate of title for a motor vehicle that is titled in another state. The effect of the act is to relieve a person from paying the highway use tax if, within a single year, a person paid the highway use tax in this State, moved to a different state and titled the motor vehicle in that state, and then moved back to North Carolina and titled the vehicle in this State.

The highway use tax is a titling tax that is collected whenever a certificate of title is issued. A resident of North Carolina is required to have a certificate of title for each vehicle the resident owns that is operated on the highways. The highway use tax is 3% of the value of the vehicle, subject to a maximum tax of $1,500 and a minimum tax of $40 until July 1, 1996. Beginning July 1, 1996, the minimum tax is repealed.

Under current law, there are two provisions for motor vehicles brought into North Carolina from another state. Under G.S. 105-187.6, the maximum highway use tax that maybe

imposed on a vehicle that has been titled in another state for at least 90 days is $150.00. Under G.S. 105-187.7, a person is allowed a credit against the highway use tax for the amount of a substantially equivalent tax imposed and paid to another state within 90 days before applying for a certificate of title.

1995 Chapter 533 (Senate Bill 710, Sen. Kincaid)

AN ACT TO INCREASE THE NORTH CAROLINA SELF-INSURANCE GUARANTY FUND AND TO ALLOW A CREDIT AGAINST THE GROSS PREMIUMS TAX FOR ASSESSMENTS PAID BY SELF-INSURERS TO THE GUARANTY FUND.

This act represents one part of a two-part plan to address the self-insured workers compensation market. At the present time, over 55% of the employees in the State have workers compensation coverage through either self-funded plans or pools. These plans or pools are currently unregulated by the Department of Insurance and several are skirting potential insolvency. This act seeks to put the Self-Insurance Guaranty Fund in a better position that it currently is to pay claims if insolvencies occur. The second part of the plan was embodied in Senate Bill 931, ratified as Chapter 471 of the 1995 Session Laws. Under that act, the Department of Insurance was given more regulatory oversight over the self-insured plans or pools. That part of the plan seeks to decrease the risk of insolvencies among this group of insurers.

Under this act, the Self-Insurance Guaranty Fund cap is raised from $1,000,000 to $5,000,000. The Fund is financed by assessments paid by self-insurers. These assessments represent .25% of the self-insurers premiums tax base. The assessment is credited toward the insurers premium tax liability. As such, any assessments paid by self-insurers are deducted from their tax payments and represent a loss to the General Fund. The act is expected to decrease General Fund revenues $1.8 million in fiscal years 1995-96 and 1996-97 and $400,000 in fiscal year 1997-98. It is assumed that the $5,000,000 cap will be reached within three years and that continued assessments beyond the third year will not be needed.

The assessments paid by self-insurers to the Self-Insurance Guaranty Fund differ from the assessments paid by private insurers in two respects:

1. The assessment is paid to the State. The amount assessed is "diverted" from gross premium tax revenue. With private insurers, the assessment is paid to the private Guaranty Fund. The premium tax liability is not affected. However, the General Assembly allows a credit against an insurer's premium tax liability equal to the amount paid by the insurer to the Guaranty Fund.
2. The amount paid as an assessment is determined by the State. Therefore, the amount of potential loss to the General Fund is more fixed.

1995 Chapter 543 (Senate Bill 202, Sen. Albertson)

AN ACT TO ENCOURAGE THE COMPOSTING OF POULTRY CARCASSES AND PROVIDE AN INCOME TAX CREDIT FOR POULTRY COMPOSTING FACILITIES.

This act creates a temporary income tax credit for constructing a facility in this State for the composting of poultry carcasses resulting from commercial poultry operations. The credit is available only to individuals and shareholders in Subchapter S corporations; it is not available to C corporations. The amount of the credit allowed is 25% of the installation, equipment, and

materials cost of building the facility, not to exceed $1,000. The credit does not apply to costs paid with funds provided to the taxpayer by a State or federal agency. The amount of the credit allowed cannot exceed the amount of tax imposed for the taxable year.

The credit is effective for taxable years beginning on or after January 1, 1995, and expires for taxable years beginning on or after January 1, 1998. The yearly General Fund revenue loss from the credit is not expected to exceed $350,000.

A poultry composting facility is a structure or an enclosure in which whole, unprocessed poultry carcasses are decomposed by a natural process into an organic, biologically safe by-product that can be used for plant food. Every person that is engaged in raising poultry for commercial purposes and has a flock of at least 200 fowl is required by G.S. 106-549.70 to dispose of the poultry carcasses in a pit, an incinerator, or a poultry composting facility that has been approved by the Department of Agriculture.

The purpose of the credit is to encourage people who raise turkey, chickens, or other poultry to compost the dead poultry rather than burn it or put it in a pit. By composting the poultry carcasses, the by-product can be converted into a useful product.

In the poultry business, the grower of a bird is often not the owner of the bird. The burden of disposing of poultry mortalities is usually on the grower of the bird.

Recommended by the Agriculture and Forestry Awareness Study Commission.

1994

Prepared by Cynthia Avrette, Sabra J. Faires, and Martha H. Harris

1994 Chapter 10, 1994 Extra Session (Senate Bill 151, Sen. Daniel)

AN ACT TO REDUCE THE UNEMPLOYMENT INSURANCE TAX RATE.

During the 1994 Extra Session on crime, the General Assembly enacted this act, which reduces unemployment insurance taxes for employers. A related act, enacted during the subsequent 1994 Regular Session, increases unemployment benefits for workers. Because the unemployment insurance tax rate had been increased and benefits had been reduced in 1983, the reduction of the tax rate during the 1994 Extra Session was viewed as only the first part of a two-part package to restore both employees and employers to their pre-1983 status regarding both the tax and benefits. Together, the two acts provide relief to both workers and employers.

Tax Rate Reduction for Employers

This act reduces the standard beginning contribution rate for unemployment insurance tax from 2.25% to 1.8% of the employer's wages paid during a calendar year for employment occurring after December 31, 1993. Effective January 1, 1994, it also reduces the tax rates that apply to rated employers with a credit balance in their unemployment insurance tax account in two ways, by reducing the rates in the rate schedule applicable to these employers and by providing an additional reduction in years in which there is a specified minimum balance in the Unemployment Insurance Fund. In 1993, the General Assembly enacted legislation that reduced the unemployment tax contribution rate by 30% for rated employers with a credit balance in their unemployment insurance tax account for any calendar year in which the balance in the Unemployment Insurance Fund equals or exceeds $800,000,000 as of the preceding August 1. This act increases that reduction, providing these employers with a 50% reduction in their contribution rate for the 1994 calendar year and for any calendar year in which the balance in the Unemployment Insurance Fund equals or exceeds $800,000,000 as of the preceding August 1.

The act's changes in the rate schedule along with the conditional change of the rate reduction from 30% to 50% will combine to give rated employers with positive credit balances an average tax reduction of 38% (the actual reduction for an individual employer depends on the employer's experience rating). A rated employer is an employer who has had a chargeable account for more than 13 consecutive months immediately preceding the date for calculating the employer's tax rate. The act's change in the standard beginning tax rate will provide a 20% tax reduction for employers who are not yet rated. The Employment Security Commission projected that the act will reduce employer tax payments by more than $67 million in 1994 and more than $73 million in 1995. Most North Carolina employers will benefit from the act; only those rated employers who have taken out more in unemployment benefits than they have put in will not experience a rate reduction. The Employment Security Commission estimates that the remaining 95% of employers will save an average of $22.00 in taxes per worker employed.

Unemployment tax contributions are paid by employers on a quarterly basis and deposited into the State Unemployment Insurance Fund. After deducting any refunds payable

from the Fund pursuant to G.S. 96-10(f), the money is deposited with the secretary of the treasury of the United States to the credit of this State's account in the Unemployment Trust Fund. Funds in the State's account earn interest that is also credited to the account. As money in the State's account is needed to pay benefits, it is transferred to the State and credited to the benefits account of the State's Unemployment Insurance Fund to be used to pay benefits to people who lose their job through no fault of their own.

North Carolina's account in the federal trust fund is one of the most solvent accounts of any state in the country. In 1994, the State's account in the trust fund had a balance of $1.49 billion, the fifth largest account in the nation, despite the 1993 legislation providing a 30% cut in the rate for rated employers with a credit balance. North Carolina's account has continued to grow since the 1993 tax cut because it earns interest at a high rate, because new unemployment taxes were collected on the many new jobs created in North Carolina during the past year, and because claims for unemployment benefits to be paid from the account have been consistently low. Even after the 1994 tax cut, the account is expected to grow or remain static each year.

This act is the third unemployment tax reduction in three years. As noted above, in 1993 the General Assembly reduced the tax rate for rated employers by 30%. In 1992, the General Assembly was able to suspend an additional unemployment tax collected from employers and credited to the Employment Security Commission Reserve Fund. This Reserve Fund bolsters the State Unemployment Insurance Fund. Before enactment of the 1994 legislation, North Carolina's average unemployment tax rate, 0.5%, was already the 45th lowest in the nation. The 1.8% starting rate for new employers is now the second lowest rate in the nation. The three unemployment tax reductions enacted by the General Assembly in three years have provided substantial tax relief to North Carolina employers.

Benefit Increase for Workers

During the 1994 Regular Session, the General Assembly enacted a related bill to increase unemployment benefits. House Bill 1889, AN ACT TO RESTORE UNEMPLOYMENT BENEFITS TO THEIR PRE-1983 LEVEL, TO MAKE PARTICIPATION IN REEMPLOYMENT SERVICES A CONDITION OF RECEIVING CERTAIN BENEFITS, AND TO MAKE TECHNICAL CHANGES IN THE EMPLOYMENT SECURITY LAWS, was enacted as Chapter 680 of the 1993 Session Laws (1994 Regular Session). Chapter 680 restores the pre-1983 formulas for computing unemployment benefits, implements a federal requirement concerning worker profiling and participation in reemployment services, and deletes obsolete provisions from the unemployment law. The benefit changes became effective for benefits paid to claimants whose benefit year begins on or after August 1, 1994. The other changes became effective upon ratification.

The effect of the benefit changes is to increase unemployment benefits. The specific formula changes are:

(1) Use of an individual's high quarter wages in determining the weekly benefit for an individual who is totally or partially unemployed. Prior law used an average of the two highest quarter wages. The law had changed from high quarter wages to an average of the two highest quarter wages effective October 1, 1983. Chapter 680 therefore reinstates the pre-1983 law on this issue. Section 1 makes the change for total unemployment and Section 2 makes the change for partial unemployment.

(2) Use of a multiplier of 8 2/3 in determining an individual's total benefit amount. Prior law used a multiplier of 8. The law had changed from 8 2/3 to 8 effective October

1, 1983. Chapter 680 therefore reinstates the pre-1983 law on this issue. Section 3 makes this change.

The Employment Security Commission has estimated that these benefit changes will increase benefit costs payable from North Carolina's account in the federal Unemployment Trust Fund by approximately $30 million a year. These increased costs are expected to be offset by employer tax payments and interest earnings credited to the account.

Chapter 680 also implements the mandates of the federal Unemployment Compensation Amendments of 1993, Pub. L. 103-152. That law requires states to establish a worker profiling system that identifies claimants for unemployment benefits who need reemployment services to become employed and to impose participation in the needed reemployment services as a condition of receiving unemployment benefits. Sections 4 through 6 make these changes. Examples of reemployment services are assessments of skills, job search workshops, and providing information on jobs. Finally, Chapter 680 deletes obsolete provisions and language from the unemployment laws.

1994 Chapter 582 (House Bill 80, Rep. Gamble)

AN ACT TO REDUCE THE TIME ALLOWED THE DEPARTMENT OF REVENUE TO MAKE ASSESSMENTS OF TAXES FOLLOWING A FEDERAL DETERMINATION, TO REINSTATE AN INADVERTENTLY DELETED PROVISION RELATING TO ASSESSMENTS FOR EMPLOYER WITHHOLDING BASED ON FEDERAL DETERMINATIONS, AND TO CLARIFY THE ASSESSMENT STATUTES.

This act makes three substantive changes and several technical changes to the statutes concerning the assessment of certain State taxes by the North Carolina Department of Revenue after the federal Internal Revenue Service (IRS) has corrected or otherwise determined a taxpayer's liability for a federal tax that affects the amount of State tax owed. The changes become effective January 1, 1995, and apply to assessments of taxes for which the time period for making assessments has not yet expired. The act is expected to have no significant effect on State revenues.

The substantive changes affect the statute of limitations that applies to assessments of State income, gift, or withholding taxes following a federal determination. The changes reduce the period of time the Department of Revenue has to assess an underpayment of State income or gift taxes following a federal determination of federal income or gift taxes, give the Department of Revenue a longer time to make an assessment of State withholding taxes following a federal determination of withheld federal employment taxes, and give taxpayers a longer time to file an amended State gift tax return following a federal determination of federal gift tax liability.

The technical changes consolidate into G.S. 105-241.1(e) the various limitation periods on making assessments following a federal determination and make technical changes in the wording of G.S. 105-241.1(b), (i), and (j). The various limitation periods are moved to G.S. 105-241.1 from G.S. 105-230.20 (corporate income tax), G.S. 105-259 (individual income tax), G.S. 105-160.8 (estate and trust income tax), and G.S. 105-197.1 (gift tax) to avoid duplication in the statutes and to establish a uniform period for these taxes.

A federal determination is a report by the Internal Revenue Service (IRS) that a taxpayer has not filed a return or has filed an incorrect return and, consequently, either owes more taxes or is entitled to a refund. If a taxpayer did not file a return or understated the

amount due on a return, the determination states the amount of tax the IRS finds is due and serves as the federal notice of assessment. The IRS eventually sends the appropriate state a copy of a federal determination. A delay between when a taxpayer receives a federal determination and when a state receives a copy of the determination occurs when the taxpayer is in the process of resolving with the IRS questions raised by the determination.

Under the State income tax laws, a taxpayer who receives a federal determination of federal income tax must, within two years, file an amended State income tax return with the Department of Revenue reflecting the determination. Under the State gift tax laws, a taxpayer who receives a federal determination of federal gift tax must, within 30 days, file an amended gift tax return reflecting the determination. This act extends from 30 days to two years the period of time in which a taxpayer must file an amended gift tax return following a federal determination. In making this change, the act establishes a uniform period for both income and gift taxes.

Until January 1, 1995, if a taxpayer files an amended State income or gift tax return in response to a federal determination, the Department of Revenue has three years from the time it receives the return to make an assessment of State income or gift tax. If a taxpayer does not file an amended return in response to a federal determination, the Department of Revenue has five years from the date it receives a copy of the determination from the IRS to make an assessment of State income or gift tax. This act shortens the additional three-year period to one year and shortens the additional five-year period to three years. Thus, under the act, the Department of Revenue has an additional one-year period to make an assessment of State income or gift tax when a taxpayer files an amended return within two years of receiving a federal determination, and the Department has an additional three-year period to make an assessment after receiving notice from the IRS of a federal determination when a taxpayer does not file the required amended return.

The general limitations period for an assessment of any State tax is three years after a return was filed or due to be filed. The one-year and three-year periods following a federal determination are in addition to the regular three-year period, which is set in G.S. 105-241.1. An additional time period is necessary when a federal determination is made to allow the State adequate time to respond to the federal determination. The State may not receive an amended return following a federal determination or a notice of a federal determination from the IRS until near the end of or after the end of the general three-year period.

Unlike the income tax laws, the withholding tax laws do not give the State any additional time to make an assessment following a federal determination. Therefore, for an assessment of withholding taxes, the State must make an assessment within the general three-year time period for making assessments. When the State does not receive notice of a federal determination of employment taxes until near the end of or after the end of this three-year period, the State is foreclosed from making an assessment.

This act gives the State the same additional one-year or three-year period to make an assessment of withholding taxes following a federal determination of federal employment taxes that it gives for assessments of income or gift taxes following a federal determination. In making this change, the act restores part of the 1990 law on assessments for withholding taxes. Until 1990, the withholding tax laws gave the same additional time periods for making an assessment after a federal determination that the income tax and gift tax laws provide. In 1990, the withholding tax statutes were extensively rewritten to speed up payments of withheld taxes. As part of the changes, G.S. 105-163.17 was rewritten and the cross-reference to the additional time periods was inadvertently deleted. The act reinstates additional time periods following a

federal determination but shortens the allowed additional time periods to either one year or three years as described for income and gift taxes.

Sections 1, 2, 3, and 6 of the act rewrite the individual income tax statute, the corporate income tax statute, the estate and trust income tax statute, and the gift tax statute, respectively, concerning federal determinations to delete the portions that are consolidated into rewritten G.S. 105-241.1(e) in Section 5 of the bill. Section 4 of the bill adds a statute that gives additional time periods for making an assessment of withholding taxes following a federal determination. Section 5 rewrites part of the assessment statute, G.S. 105-241.1, to consolidate the various time periods that apply to assessments and to make the statute easier to understand.

The act does not affect assessments of State inheritance tax following a federal determination of federal estate tax, nor does it affect when interest begins to accrue on an overpayment of State income, gift, or withholding tax. The act deletes language from several statutes that directs the Department of Revenue to refund overpayments of tax within 30 days because the language is unnecessary and confusing. The 30-day limit does not determine when interest begins to accrue on overpayments and has no practical effect. G.S. 105-266(a) requires the Department of Revenue to refund overpayments of any tax as soon as possible, and G.S. 105-266(b) states when interest begins to accrue on overpayments.

The act stems from a recommendation of the Revenue Laws Study Committee. The recommendation of the study committee covered only the additional periods for an assessment of State withholding taxes after a federal determination and the technical changes.

1994 Chapter 584 (Senate Bill 1045, Sen. Allran)

AN ACT TO BROADEN EXISTING INCOME TAX CREDITS FOR THE PRODUCTION AND INSTALLATION OF SOLAR AND PHOTOVOLTAIC EQUIPMENT BY INCREASING THE AMOUNTS OF THE CREDITS AND EXTENDING THE SOLAR EQUIPMENT CREDITS TO INCLUDE EQUIPMENT THAT GENERATES ELECTRICITY.

This act broadens two existing corporate and individual income tax credits concerning the installation of solar energy equipment and one existing corporate income tax credit concerning the production of photovoltaic equipment. Photovoltaic equipment is equipment that uses solar energy to produce electricity. The act is effective for taxable years beginning on or after January 1, 1994, and is expected to result in an annual decrease in General Fund revenues of between $127,500 and $178,500. The changes made by the act to each credit are described below.

<u>Credits for Installing Residential Solar Energy Equipment</u>

- Increases the costs for which a credit can be claimed from 25% to 40%.
- Increases the maximum credit per system from $1,000 to $1,500.
- Expands the credit to include photovoltaic equipment.
- Increases from 3 years to 5 years the number of years a credit can be carried forward.

<u>Corporate Credit For Constructing Photovoltaic Equipment Facility</u>

- Increases the costs for which a credit can be claimed from 20% to 25%.

<u>Credits for Solar Equipment Used To Produce Heat in Certain Processes</u>

- Increases the costs for which a credit can be claimed from 20% to 35%.
- Increases the maximum credit for an installation from $8,000 to $25,000.
- Expands the credit to include the production of electricity.

The corporate income tax credit for installing residential solar equipment is available to corporations that construct or install solar energy equipment in residential buildings used or sold by the corporation for commercial or business purposes. The credit is available to the corporation that owns or controls the use of the building when the equipment is installed or, in the case of a building constructed to be sold, to the owner who first occupies or leases the building for use. The credit taken may not exceed the amount of income taxes imposed on the person taking the credit and a credit is not allowed to the extent any of the cost of the equipment was provided by federal, State, or local grants. A similar individual income tax credit is allowed.

The photovoltaic corporate income tax credit is allowed to a corporation that constructs a facility in North Carolina for the production of photovoltaic equipment. The credit may not exceed the amount of income tax imposed on the corporation and it is not allowed to the extent that any of the costs were provided by governmental grants. Any excess credit may be carried forward for five years. There is no parallel individual income tax credit.

The credit for installing solar equipment to produce heat is allowed to a corporation or an individual for constructing or installing solar equipment to produce heat in the manufacturing or service processes of a business located in North Carolina. The credit may not exceed the amount of tax imposed on the corporation or individual and the credit is not allowed to the extent that any of the costs were provided by governmental grants.

1994 Chapter 600 (House Bill 1663, Rep. Black)

AN ACT TO EXEMPT ALL ANNUITIES AND FUNDING AGREEMENTS FROM PREMIUM TAXATION; TO CLARIFY THE AUTHORIZATION FOR THE ISSUANCE OF AND ESTABLISH STANDARDS FOR FUNDING AGREEMENTS; AND TO MAKE CONFORMING CHANGES IN LAWS ON PRIORITY OF DISTRIBUTION OF ASSETS OF INSOLVENT INSURERS AND ON SECURITIES.

This act changes the insurance laws by authorizing certain insurers to issue funding agreements in this State, subject to regulation by the Department of Insurance, and by changing the priority of certain claims against the assets of an insolvent insurance company. The act changes the tax laws by exempting all annuities and the new funding agreements from the gross premiums tax levied on insurance companies and by making technical changes to the statute that imposes the gross premiums tax to make the statute easier to understand. These tax changes become effective January 1, 1995; the rest of the act became effective July 1, 1994.

A funding agreement is, in effect, a kind of annuity. It is an agreement between an insurer and another person for the person to provide funds to the insurer and for the insurer to pay the funds, in one or more payments, to a designated person at a future date based on contingencies other than death or disease. For example, a party responsible for cleanup of a hazardous waste site could use a funding agreement for the cleanup. The party could deposit funds with an insurer pursuant to a funding agreement that would establish a periodic payment schedule and the time period for the cleanup.

The act changes the priority in insurer insolvency proceedings of the portion of a benefit claim that exceeds $300,000. Under prior law, the portion above this amount had no priority and was in the same status as claims of general creditors. The act gives the portion of a benefit claim that exceeds $300,000 the same priority as the portion that does not exceed this amount and clarifies that claims under funding agreements are to be given the same priority as other claims for benefits.

As part of the goal of the act to remove obstacles to the issuance of funding agreements in this State, the act repeals the gross premiums tax on annuities. Prior law imposed a gross premiums tax of 1.9% on annuities. The tax was payable at the "back end" rather than the "front end," which means that the tax was paid when the annuity payments began rather than when money was deposited with the insurance company to fund the annuity. When payments on an annuity began, the tax was calculated as 1.9% of the present value of the stream of income to be received under the annuity. The insurer deducted the amount of the tax from the initial payments to be made under the annuity. North Carolina was one of about 13 states that imposed a premiums tax on annuities. Of these, about five either required or allowed the tax to be computed and paid at the "back end" rather than the "front end."

The exemption of annuities from the gross premiums tax has two fiscal effects. First, it decreases premiums tax revenue each fiscal year by approximately $1 million. Second, because it reduces the amount of premiums tax payable, it reduces by approximately $72,500 the amount collected each fiscal year from the insurance regulatory charge. That charge, which is imposed by G.S. 58-6-25, is set annually and, for the 1994 taxable year, is 7.25% of gross premiums tax liability.

The technical changes to the gross premiums tax statute, G.S. 105-228.5, break the statute into subsections, delete incorrect cross-references, clarify that the gross premiums tax is in lieu of only income and franchise taxes, and delete obsolete provisions. The act makes no substantive change to G.S. 105-228.5 other than to repeal the tax on annuities.

1994 Chapter 661 (Senate Bill 1377, Sen. Winner of Buncombe)

AN ACT TO CONFORM THE THRESHOLD FOR DETERMINING IF A PENALTY APPLIES TO AN UNDERPAYMENT OF WITHHELD STATE INCOME TAXES TO THAT USED UNDER THE INTERNAL REVENUE CODE FOR DETERMINING IF A PENALTY APPLIES TO AN UNDERPAYMENT OF WITHHELD FEDERAL INCOME TAXES, AND TO CLARIFY THE TYPE OF INFORMATION A TAXPAYER MUST PROVIDE TO THE SECRETARY OF REVENUE.

This act makes one substantive change to the State law concerning payment to the Department of Revenue of withheld State income taxes plus two technical changes to this law and a clarifying change concerning the kinds of information the Secretary of Revenue can ask a person who is required to file any tax return or report to provide. Section 1 of the act makes the State withholding tax changes and Section 2 makes the clarifying change concerning tax information. The State withholding tax changes become effective January 1, 1995, and apply to payments of withheld State income taxes made on or after that date. The clarifying change concerning tax information became effective upon ratification. This act was recommended by the Revenue Laws Study Committee. The withholding tax change is expected to cause a minimal increase in General Fund revenues because it accelerates slightly the payment schedule for underpayments of withholding tax and lowers slightly the threshold for imposing penalties for underpayments of withholding tax.

The substantive change to the State withholding tax laws ties the State penalty provisions concerning payments by employers of withheld State individual income taxes to the federal penalty provisions that apply to payments to the Internal Revenue Service of federal employment taxes attributable to the same wages. The immediate effect of this change is twofold. First, it changes the amount of a shortfall in the remittance of withheld State income taxes that triggers the imposition of interest and penalties from the current State amount to the current federal amount. Second, it changes the time by which a shortfall must be remitted in order to avoid the imposition of penalties and interest. The continuing effect of the change is to adjust the State provisions for determining when an employer is subject to interest and penalties on a shortfall in withheld State income taxes automatically in accordance with changes in the corresponding federal provisions.

Under prior State law, an employer who did not remit the full amount of State income taxes withheld from wages by the date they were due was not liable for interest or penalties on the shortfall if the amount of the shortfall was less than 5% of the amount due and the employer included the amount of the shortfall in the next withholding tax return the employer filed. A return is due quarterly by the last day of the month following the end of the quarter.

Under current federal law, an employer who does not remit the full amount of federal employment taxes attributable to wages by the date they are due is not liable for interest or penalties on the shortfall if the amount of the shortfall does not exceed the greater of 2% of the amount due or $100 and the employer remits the shortfall by the shortfall make-up date. The shortfall make-up date for an employer who remits monthly is the due date of the quarterly return. The shortfall make-up date for an employer who remits on a semi-weekly basis is the first Wednesday or Friday that falls on or after the 15th day of the month following the month in which the remittance was required to be made. Federal employment taxes attributable to wages are withheld federal income taxes, withheld employee old age, survivor, and disability insurance taxes and hospital taxes, the employer's corresponding old age, survivor, and disability insurance taxes and hospital taxes, and certain amounts withheld under the backup withholding requirements.

Thus, the immediate effects of the act are to delete the 5% shortfall threshold and substitute a threshold that is the greater of 2% or $100, and to require employers who remit on a semi-weekly basis to remit a shortfall by approximately the 15th day of the month following the month in which it occurred instead of at the time the employer files the next quarterly return. The result is that the shortfall threshold for determining whether a penalty applies and the due date of a shortfall will be the same for federal and State law; to avoid interest or a penalty on a shortfall of withheld State income taxes, an employer must remit more of the total amount payable by the due date and remit any shortfall within a shorter amount of time than was required under prior State law.

In addition to the substantive change, the act makes two technical changes to the State withholding tax laws. First, it changes the phrase "federal income taxes withheld from the same wages" to "federal employment taxes attributable to the same wages" because this latter phrase is more accurate. As noted above, federal income tax withheld from wages is only one of the kinds of taxes that are included under federal law in applying the test for determining when interest and penalties apply.

Second, it changes the phrase "within three banking days" to "semi-weekly" for the same reason; the former phrase is no longer accurate. Effective January 1, 1993, the Internal Revenue Service changed the designation of employers who are required to remit more frequently than on a monthly basis from a "within three-banking-day" employer to a "semi-weekly" employer

to reflect changes in the payment schedule for employers. The Internal Revenue Service abandoned the eighth-monthly periods in favor of semi-weekly periods. Under the former law, an employer who accumulated $3,000 or more in employment taxes in any eighth-monthly period had to remit the taxes within three banking days after the end of that eighth-monthly period. Under the revised regulations, employers who paid at least $50,000 of employment taxes in the previous 12-month period ending June 30 must remit whatever amount of employment taxes they accumulate in a semi-weekly period. One semi-weekly period consists of Wednesday, Thursday, and Friday; employment taxes attributable to wages paid in this period are due on or before the following Wednesday. The other semi-weekly period consists of Saturday, Sunday, Monday, and Tuesday; employment taxes attributable to wages paid in this period are due on or before the following Friday.

The State withholding tax changes made by this act keep the penalty provisions concerning payments of withheld State income taxes consistent with the intent of the 1990 act of the General Assembly that revised the laws concerning payment of these taxes. Chapter 945 of the 1989 Session Laws (1990 Regular Session) revised the withholding tax provisions to require payment of the taxes on a faster basis. It did so by putting payment of the taxes by larger employers on the same schedule that applied under federal law. As part of the changes, that act set the penalty provisions to mirror the federal ones. The federal law changed in 1993, however, and a corresponding change was not made to State law.

Section 2 of the act makes a clarifying change concerning information provided by taxpayers. It updates the law that requires various entities to complete tax returns and answer questions submitted to them by the Secretary by incorporating the definitions of "person," "Secretary," and "taxpayer" that now apply to this law and by referring specifically to reports as well as returns. It also clarifies the type of information the Secretary can require a taxpayer to provide by enumerating the permissible kinds of information.

The changes concerning tax information were included in the act because, in reviewing the State withholding tax changes, the Revenue Laws Study Committee became concerned about the scope of information the Secretary could request. The State withholding tax law required a person who must file a withholding tax return to provide any information requested by the Secretary. The Committee wanted to ensure that all information requested is related to a determination of tax liability. The requirement that a person provide any information requested by the Secretary appears throughout Chapter 105 of the General Statutes. To provide a uniform policy on tax information, the Committee therefore decided to amend the appropriate statute in Article 9 of Chapter 105 rather than make a change that applies only to information about withholding taxes. Article 9 of Chapter 105 contains the administrative provisions that apply to all taxes administered by the Secretary under that Chapter.

1994 Chapter 662 (Senate Bill 1619, Sen. Winner of Buncombe)

AN ACT TO UPDATE THE REFERENCE TO THE INTERNAL REVENUE CODE USED IN DETERMINING CERTAIN TAXABLE INCOME AND TAX EXEMPTIONS AND TO RESOLVE AN UNINTENDED CONFLICT BETWEEN THE STATUTE OF LIMITATIONS FOR CERTAIN TAX REFUNDS AND THE LAW ALLOWING DEDUCTIONS FOR CARRYBACKS, BAD DEBTS, AND WORTHLESS SECURITIES.

This act rewrites the definition of the Internal Revenue Code used in State tax statutes to change the reference date from January 1, 1993, to January 1, 1994, and revises the tax

refund statute of limitations to eliminate an unintended conflict between that statute and the law allowing deductions for carrybacks, worthless debts, and worthless securities.

The act updates the Internal Revenue Code reference, thus making recent amendments to the Code applicable to the State to the extent that State tax law previously tracked federal law. This update has the greatest effect on State corporate and individual income taxes because these taxes are based on federal taxable income and are therefore closely tied to federal law. The franchise tax, gift tax, highway use tax, inheritance tax, insurance company premiums tax, and intangibles tax also determine some exemptions based on the provisions of the Code. The federal Omnibus Budget Reconciliation Act of 1993 enacted a number of different changes that affect individual and corporate income tax. The following are among the most important of the federal changes that affect the State:

1. Changes in the moving expense deduction.
2. Valuation of securities dealers' inventory at fair market value; securities not in inventory are considered to have been sold at fair market value.
3. Reduction of the amount of qualifying business meals and entertainment expenses that may be deducted, from 80% to 50%.
4. Repeal of the deduction for certain club dues.
5. Expansion of the rules for amortization of certain intangible business assets, including goodwill.
6. Elimination of passive loss restrictions for certain real estate professionals.
7. Retroactive extension of the health insurance deduction for self-employed individuals.
8. Increase in the recovery period for depreciation of non-residential property, from 31.5 years to 39 years.
9. Deduction for wages of the CEO and four highest paid officers of a public corporation limited to $1 million each.
10. Repeal of the deduction for lobbying expenses.

The act also eliminates an inconsistency in the tax law. Since 1989, the State individual income tax law has conformed to the federal law that allows a taxpayer to carry net operating losses and certain capital losses back to the three previous tax years and then forward for fifteen years. Under the new law, the first tax year to which a loss could be carried back is 1989, which means that carrybacks were allowed beginning with losses incurred in 1992. To deduct the loss carryback for the 1989 tax year, the taxpayer must file an amended return for that year. The taxpayer would first learn of the loss in preparing the tax return for the 1992 tax year, which was due April 15, 1993, for calendar year taxpayers. Under federal law, the taxpayer has three years from the due date of the 1992 return to claim the loss carryback on an amended return for 1989. Under prior North Carolina law, however, the normal statute of limitations applied: the loss had to be claimed within three years after the due date of the 1989 return. Thus, in most cases, the taxpayer would have had to file the amended return within days or weeks of learning the deduction was available.

This discrepancy in the law occurred because, at the time the law was changed to allow loss carryback deductions, no conforming change was made to the statute of limitations to allow time to file for the deductions. The act makes this conforming change so that the usual three-year

period for claiming refunds will run, in the case of loss carryback deductions, from the due date of the return for the year the loss occurs rather than the year to which the deduction is carried back.

Another change made by the act conforms the State individual income tax law to the federal law that allows a seven-year period for claiming a refund due to a deduction for a worthless debt or a worthless security. This longer period is considered equitable because of the complexity under federal law of determining when a debt or security became worthless and, consequently, which year is the appropriate year for taking the deduction. A security becomes worthless for federal tax purposes not when it loses value but when the taxpayer has no reasonable expectation that it will become valuable at some future time. A debt becomes worthless for federal tax purposes when there are identifiable events that have caused the taxpayer to reasonably abandon hope of ever recovering any payment. In many cases, a taxpayer may take the deduction for the wrong year and learn much later that the deduction should have been taken for a different year. Without the longer statute of limitations, the taxpayer could not then file an amended return to take the deduction and claim a refund for the appropriate year.

The conforming changes made by the act to the statute of limitations are retroactive to the 1989 tax year, the year in which the changes were first needed. Interest on refunds due to loss carrybacks will run, however, only from 45 days after the filing date of the return for the year in which the loss occurred rather than from the year to which the loss is carried back. For example, if the taxpayer is a calendar year taxpayer, interest on a refund for a loss that occurred in 1992 and is carried back to 1989 will run only from May 30, 1993, which is 45 days after the April 15 due date of the 1992 return.

The Department of Revenue estimates that the revenue gain from conforming the Internal Revenue Code reference to the latest federal changes will be approximately $5 million in the 1994-95 fiscal year. The estimated loss from the net operating loss carryback change is a one-time loss of $3.4 million in the 1994-95 fiscal year. Therefore, the net impact of this act is a gain to the General Fund of $1.6 million for the 1994-95 fiscal year and a gain of at least $5 million for each fiscal year thereafter.

1994 Chapter 674 (Senate Bill 716, Sen. Kerr)

AN ACT TO MODIFY THE CORPORATE INCOME TAX CREDIT FOR CONSTRUCTION OF A COGENERATING POWER PLANT BY (1) PROVIDING THAT A PARTNERSHIP MAY QUALIFY FOR THE CREDIT, (2) CLARIFYING THAT A PARTNERSHIP MAY PASS AN INCOME TAX CREDIT THROUGH TO ITS PARTNERS, (3) EXPANDING THE CREDIT TO INCLUDE NATURAL GAS COGENERATING POWER PLANTS, (4) PROVIDING AN ALTERNATIVE METHOD TO CALCULATE THE CREDIT, (5) LIMITING THE AMOUNT OF CREDIT THAT MAY BE ALLOWED EACH YEAR EFFECTIVE BEGINNING IN 1994, AND (6) RESTRICTING THE CREDIT TO NATURAL GAS COGENERATING POWER PLANTS EFFECTIVE BEGINNING IN 1998.

This act modifies the corporate income tax credit for construction of a cogenerating power plant and codifies the principles that apply to all income tax credits of partnerships. The modifications to the cogenerating power plant tax credit that broaden the credit are effective for taxable years beginning on or after January 1, 1993, and the modifications that limit the credit become effective for taxable years beginning on or after either January 1, 1994 or January 1, 1998, as explained below. The codification of the principles that apply to all income tax credits of partnerships is effective for taxable years beginning on or after January 1, 1993.

The changes to the cogenerating power plant tax credit are expected to decrease General Fund tax revenue annually by an amount that ranges from $275,000 in fiscal year 1994-95 to $800,000 in fiscal year 1997-98; codification of the principles that apply to income tax credits of partnerships has no fiscal impact.

The cogenerating power plant tax credit, set out in G.S. 105-130.25, is a corporate income tax credit that has no parallel individual income tax credit. Until this act, the credit applied to 10% of the costs of purchasing and installing in a power plant equipment that sequentially produced electrical or mechanical power and useful thermal energy from a shared power source that used a fuel other than residual oil, middle distillate oil, gasoline, natural gas, or liquid propane gas. The credit was allowed only for costs paid during the taxable year, could not exceed the amount of tax owed for the taxable year, and could not be carried forward or backward if the allowable credit exceeded the amount of tax owed.

The act both broadens and limits this tax credit and sets out the current administrative practice concerning the availability of the credit to a corporate partner in a partnership. Section 1 of the act broadens the credit in two ways. First, it extends the credit to cogenerating equipment fueled by natural gas. Second, it gives a corporation the option of cumulating costs paid for cogenerating equipment in years before a plant becomes operational and claiming a credit for the cumulated costs in the year the plant becomes operational. Prior to this act, natural gas was not an allowable fuel source and the cost of cogenerating equipment could be claimed as a credit only in the year the cost was paid.

If a corporation chooses the optional method of calculating costs and claims a credit for cumulated costs in the year the plant becomes operational, the credit cannot exceed one-fourth of the amount of corporate income tax the corporation owes for the taxable year reduced by any other credits allowed the corporation. Other credits allowed the corporation for the taxable year include carry-forwards of the cogenerating credit. If the credit claimed exceeds this one-fourth limitation, the excess can be carried forward for the next 10 taxable years. To carry forward an amount that exceeds the one-fourth limitation, however, a corporation must submit an application for the credit for each year the corporation seeks to claim the carry-forward.

Sections 2 and 4 of the act limit the credit in three ways. Section 2 sets an annual ceiling on the credit and creates a one-year delay in taking the credit. Section 4 eventually allows a credit only for cogenerating equipment fueled by natural gas.

Beginning in taxable year 1994, the act sets a ceiling of $5 million on the amount of cogenerating power plant credits that can be taken in a taxable year by all corporations combined. The amount of any cogenerating credits to be carried forward from a previous year is included in determining whether the total amount claimed for a year exceeds the ceiling. Current law does not set a ceiling on the total amount of credits that can be claimed. The amounts claimed for the taxable years for which the credit has been in effect have ranged from zero to $2.9 million, and the total amount claimed for all taxable years for which the credit has been in effect is approximately $6.1 million. The ceiling was enacted to prevent a large loss in any one year due to the new option of cumulating costs.

Under the revised credit, if the amount claimed by all corporations exceeds the $5 million ceiling, the credit claimed by each corporation is reduced proportionally until the total reduced amount does not exceed the ceiling. A corporation whose credit is reduced to meet the ceiling may carry the amount of the reduction forward for the next 10 taxable years. To carry the amount forward, however, the corporation must submit an application for the credit for each year the corporation seeks to claim the carry-forward. An annual application is necessary to

enable the Department of Revenue to determine for each year whether the amounts claimed exceed the $5 million ceiling.

The act further limits the credit by delaying by one year the tax period for which the credit can be taken. Until taxable year 1994, a corporation that claims a credit for a taxable year takes the credit for the year the credit is claimed. Thus, a corporation that claims a credit for the 1993 taxable year can subtract the amount of the credit from the amount of tax due for the 1993 taxable year. Starting with the 1994 taxable year, a corporation must apply for the credit in one year and then take the credit in the following year. This delay is a result of the $5 million ceiling. The delay allows the State to determine in advance of a taxable year whether the credits claimed for that year will exceed the ceiling and to notify corporations of any reduction in the credits claimed in the event the amount claimed by all corporations exceeds the ceiling.

The final limitation the act imposes on the credit is to require the cogenerating equipment to be fueled by natural gas beginning in taxable year 1998. Thus, the act first allows natural gas as a fuel source beginning in taxable year 1993 and then excludes all fuel sources other than natural gas beginning in taxable year 1998.

The act also changes the language of the credit to include a partnership as well as a corporation. This is a clarifying change rather than a substantive change, however, because corporate partners of a partnership could already take the credit under the prior law because they were corporations. Corporate partners of partnerships were allowed to take corporate income tax credits in proportion to the corporate partner's distributive share of the partnership income.

Because the application of the cogenerating credit to a corporate partner was not clear, the act codifies the principles that apply to the eligibility of a partnership for any corporate or individual income tax credit. Section 3 of the act sets out these principles. Under these principles, a partner in a partnership is eligible for a credit if the partnership qualifies for the credit and the partner could take the credit if the partner stood in the position of the partnership. Thus, an individual partner in a partnership could not take the cogenerating credit because the credit is not available to individuals.

Partnerships qualify for corporate income tax credits on behalf of their corporate partners. Whether a partnership qualifies for an individual income tax credit depends on the wording of the credit. For example, a partnership qualifies for an individual income tax credit that is allowed to a person, but not one that is allowed to an individual or a taxpayer.

The amount of a credit that can be taken by a partner is determined by the partner's distributive share of the partnership in accordance with sections 702 and 704 of the Internal Revenue Code. Under those sections, a partner's distributive share is determined by the partnership agreement. If the partnership agreement does not provide for the distributive shares, however, a partner's share is determined in accordance with the partner's interest in the partnership.

Any limit on the amount of a credit that can be taken or any other restrictions on a credit apply separately to each partner of a partnership that is eligible for a credit. Thus, if a credit cannot exceed 25% of a person's tax liability, the limit is calculated separately for each partner. This principle results from the nature of a partnership as a pass-through entity. In a partnership, the partners and not the partnership itself is liable for any income tax due on income earned by the partnership.

1994 Chapter 679 (Senate Bill 906, Sen. Daniel)

AN ACT TO MAKE VARIOUS SUBSTANTIVE AMENDMENTS TO THE WORKERS' COMPENSATION ACT AND TO MAKE RELATED CHANGES.

This act amends the Workers' Compensation Act to make it fairer to employees as well as to employers and to make it simpler and easier to enforce. Among the changes made by the act are two that affect tax information. The act requires employers to include information relating to their workers' compensation coverage on the annual informational return they must file with the Department of Revenue concerning the taxes deducted and withheld from their employees' wages. The employers must name their workers' compensation insurance carriers and the number and expiration dates of their policies. If self-insured, the employers will report the name of their self-insurance group, if applicable, the names of the third parties that administer their self-insurance programs, and the employer code numbers used by the Department of Insurance for these self-insureds. The act also amends the confidentiality provisions of the revenue laws to allow the Department of Revenue to release to the Industrial Commission the information it collected on the annual informational returns concerning employers' workers' compensation coverage. The act provides that these changes became effective on the date it was ratified, July 5, 1994. Employers will be required to provide the information beginning with their next annual informational return, which is due in early 1995.

1994 Chapter 681 (House Bill 1944, Rep. Redwine)

AN ACT TO EXPAND THE STATE PORTS TAX CREDIT.

This act changes the State ports income tax credit by expanding it to include any charges assessed on cargo exported by a taxpayer as well as any charges paid on the cargo exported by a taxpayer. The change, recommended by the Economic Development Board of the Department of Commerce, is effective for taxable years beginning on or after January 1, 1994. It is estimated that this act will reduce General Fund revenues by approximately $50,000 annually.

Many exporters sell their products "F.O.B. plant" (free on board plant), which means that the buyer rather than the seller (exporter) pays the cost of shipping the product, including the port costs for which the State ports income tax credit is available. Under prior law, a taxpayer could claim the ports credit only for charges paid by the taxpayer. Therefore, a taxpayer who exported a product that is shipped "F.O.B. plant" could not take the credit for that export because the taxpayer did not pay for the shipping costs.

This act eliminates the requirement that a person who claims the ports credit must have paid the shipping cost. It allows a taxpayer to claim a credit for all of the port costs assessed on cargo exported by the taxpayer, regardless of who paid the costs.

The 1992 General Assembly enacted the State ports income tax credit to encourage exporters to use the two State-owned port terminals at Wilmington and Morehead City. When the credit was enacted, 70% of North Carolina exporters and importers used ports in other states to move their cargo, even though the North Carolina ports had the capacity to accommodate the additional vessels and cargo. The amount of credit allowed is equal to the amount of charges paid to the North Carolina Ports Authority in the taxable year that exceeds the average amount of charges paid to the Authority for the past three years. The credit is limited to 50% of the tax imposed on the taxpayer for the current year. Any excess credit may be carried forward and applied to the taxpayer's income tax liability for the next five years.

The cumulative credit may not exceed one million dollars per taxpayer. The credit will expire in 1996.

1994 Chapter 697 (House Bill 1775, Rep. Luebke)

AN ACT TO RESOLVE A CONFLICT IN THE DEALER LICENSE PLATE LAW CONCERNING THE USE OF DEALER LICENSE PLATES ON VEHICLES USED BY A DEALER IN A BUSINESS THAT IS SEPARATE FROM THE BUSINESS OF SELLING MOTOR VEHICLES, AND TO PROVIDE THAT A REGISTRATION CARD ISSUED FOR A DEALER PLATE IS NOT REQUIRED TO BE SPECIFIC FOR THAT DEALER PLATE.

This act makes two changes in the dealer plate laws. First, it establishes a uniform policy on the display of dealer license plates on motor vehicles that are used in a business that is separate from a dealer's business of selling motor vehicles. It does this by repealing the one exception to the general prohibition on this type of use. Second, it allows a registration card for dealer plates to be a generic card that applies to all dealer plates issued to the same dealer rather than a card that is specific to a particular dealer plate.

The first of these two changes was proposed by the Revenue Laws Study Committee. It becomes effective July 1, 1996. The second change was added by the House Transportation Committee. It became effective upon ratification, July 6, 1994.

With one exception, the dealer license plate laws prohibit a dealer from putting a dealer license plate on a motor vehicle that is used by the dealer in a business that is separate from the business of selling motor vehicles. The one exception is for a motor vehicle dealer who also sells, trades, or services farm tractors or other farm-related equipment. The law allows these dealers to put a dealer license plate on a motor vehicle that is used to haul the farm tractors or other farm-related equipment.

This one exception to the general prohibition is the result of two conflicting provisions concerning dealer license plates that were enacted in the 1993 Session. Section 169.4 of Chapter 321 of the 1993 Session Laws, the Current Operations Appropriations Act, amended the dealer license plate laws by inserting the exception to the general prohibition. Chapter 321 was ratified on July 9, 1993; the exception was effective July 1, 1993. On July 12, 1993, the General Assembly enacted Chapter 440 of the 1993 Session Laws. Chapter 440 rewrote the dealer license plate laws to restrict the number of plates that can be issued to a dealer and to set out clearly the existing restrictions on the use of dealer plates. That act, which was recommended by the Revenue Laws Study Committee, became effective October 1, 1993.

Chapter 440 made no exceptions to the general prohibition against the display of a dealer license plate on a motor vehicle that is used in a business that is separate from a dealer's business of selling motor vehicles. The exception created by Chapter 321 remained, however, even though the exception was contrary to the intent of Chapter 440.

The result is that the current law allows a dealer who sells tractors or other farm-related equipment to put a dealer plate on a vehicle used in a business that is separate from the business of selling motor vehicles and prohibits all other dealers from a similar use of dealer plates. A dealer's business of selling motor vehicles includes only the sale of motor vehicles that must have a license plate to be driven on a highway. Consequently, if a dealer both sells and services motor vehicles, the dealer cannot put a dealer plate on a motor vehicle the dealer loans to a car owner whose vehicle is being repaired by the dealer. That dealer also cannot put a dealer

license plate on a motor vehicle the dealer uses to pick up parts for the vehicles the dealer services.

Dealers have been and are now generally restricted from using dealer license plates on motor vehicles that are used in a separate business of the dealer because this use is contrary to the purpose of dealer license plates and is difficult to reconcile with the requirement that a motor vehicle displaying a dealer license plate be part of the inventory of the dealer. The purpose of a dealer license plate is to allow a customer of the dealer to test-drive a motor vehicle offered for sale by the dealer and to allow the dealer to pick up a motor vehicle from its point of purchase by the dealer and to have the vehicle prepared for sale. Furthermore, a motor vehicle used regularly by the dealer for property-hauling purposes or any other purpose is not in fact part of the dealer's inventory.

The Revenue Laws Study Committee is concerned about the improper use of dealer plates because of the effect of the improper use on State and local revenues. A motor vehicle that is improperly driven with a dealer license plate escapes local property taxes, escapes State motor vehicle title and registration fees, and receives an unfair advantage on automobile insurance. It escapes property taxes because it is supposedly part of the inventory of the dealer and is, therefore, exempted from property tax by the exemption of inventory. It escapes motor vehicle title and registration fees because the title to the vehicle has not been transferred to the person who uses the vehicle. It enjoys an unfair advantage on insurance because it is insured through the dealer's blanket liability insurance policy rather than through a policy that is specific to the vehicle.

The second change made by the act implements a recommendation of the automobile dealers. The dealers explained that the requirement of having the proper registration card in a vehicle that displays a dealer plate becomes a logistical problem when the plates are switched in a short period of time from one vehicle to another. To solve the problem, they suggested that a dealer receive the same number of registration cards as dealer plates, but that each registration card be interchangeable and apply to any of the plates. Section 2 of the act changes the law to accommodate this request. The Division of Motor Vehicles of the Department of Transportation plans to implement the change by printing on a registration card issued for a dealer plate the series of dealer plates to which the card applies.

1994 Chapter 726 (Senate Bill 1473, Sen. Kerr)

AN ACT TO ADDRESS MOTOR FUEL TAX EVASION.

This act addresses two areas of motor fuel tax evasion: cross-border movements of fuel and the use of non-tax-paid fuel in a motor vehicle for highway use. The parts of the act addressing cross-border movements of fuel were recommended by the Revenue Laws Study Committee. The act becomes effective January 1, 1995; the resulting reduction in fuel tax evasion is expected to increase collections by an unknown amount, possibly several million dollars.

Cross-border Movement of Fuel

A cross-border movement of fuel is a movement of fuel across state borders. To avoid fuel taxes in a state with a high fuel tax rate, a person can buy fuel in one state, pay that state's tax on the fuel, bring the fuel to a state with a higher fuel tax, and then sell the fuel in that higher fuel tax state without paying the higher rate of tax. North Carolina is particularly vulnerable to tax evasion by cross-border movements of fuel because its motor fuel tax rate is

22¢ a gallon compared to 16¢ a gallon in South Carolina and 7.5¢ a gallon in Georgia. The act combats this problem through improved documentation and reporting requirements for interstate movements of fuel.

The most important change the act makes concerning cross-border movements of fuel is the "destination state" requirement. Under this requirement, a shipping paper issued by a terminal operator for fuel to be delivered by transport truck or railroad tank car must state the destination state of the fuel, the driver of the truck or the rail carrier must deliver the fuel in accordance with the listed destination state, and the buyer of the fuel is prohibited from accepting delivery if the destination state on the shipping document is not correct. Section 4 of the act contains these requirements along with sanctions for failure to comply with the requirements. For the first violation, there is a civil penalty equal to the amount of fuel tax payable on the improperly transported or diverted fuel. For a second or subsequent violation, there is a civil penalty equal to the greater of $1,000 or five times the amount of fuel tax payable on the improperly transported or diverted fuel.

Two of our neighboring states, Virginia and Georgia, have already enacted destination state legislation. The Uniformity Committee of the Motor Fuel Tax Section of the Federation of Tax Administrators is strongly encouraging all states to enact similar legislation.

In addition to the destination state requirement, the act modifies the kind of information that must be reported to the Secretary by those who receive or deliver fuel by pipeline, marine vessel, railroad tank truck, or transport truck. Section 6 of the act requires these transporters of motor fuel to report all fuel imported into or exported from the State.

Prior law required these transporters to report all fuel imported into the State and all fuel transported from one place in the State to another place in the State. It did not require the transporters to report fuel exported from the State and it did not limit reports of tank truck movements to movements of fuel by trucks that carry at least 4,200 gallons. The prior law was not enforced, however. Section 6 therefore changes the reporting requirements by deleting both the requirement that intrastate movements be reported and the requirement that trucks designed to carry fewer than 4,200 gallons file reports and by expanding the law to include reports of exports. The section also changes the date a report is due from the 10th of each month to the 25th. This later date corresponds better to the tax reports of motor fuel, which are due either on the 20th or the 25th of each month.

The other sections of the act that concern cross-border movements of fuel make conforming changes needed to implement the destination state requirement or the modified reporting requirements. Section 1 adds definitions of "bulk plant," "destination state," "rack," "terminal," "terminal operator," and "transport truck," and clarifies the definitions of "import" and "export." All of the added or modified definitions, except that of "transport truck," reflect definitions used by the Internal Revenue Service or recommended for use by the Uniformity Committee of the Motor Fuel Tax Section of the Federation of Tax Administrators. The definition of "transport truck" is used to distinguish the large transport trucks that typically carry between 8,000 and 9,000 gallons of motor fuel from the small "tank wagons" used to carry less than 4,200 gallons.

Section 2 requires terminal operators who are not already licensed as distributors of gasoline or suppliers of diesel fuel to register with the Secretary of Revenue. There are only a few of these in the State. The registration requirement is needed to enable the Department of Revenue to enforce the requirement that terminal operators print the destination state on shipping documents and make reports to the Secretary.

Section 3 modifies the requirements that apply to persons whose only connection with motor fuel in this State is to buy it for export to another state. Under prior law, these persons could buy the fuel tax-free because it is exported to another state, and they did not have to show that they were licensed for motor fuel tax purposes with the state to which the fuel is exported. The act requires these buyers of motor fuel to establish that they are registered with another state for the payment of fuel taxes to that state before they can buy tax-free fuel in this State.

Section 5 makes a conforming change to the list of Class 1 misdemeanor gasoline tax violations to include failure to give or show a shipping document when required by Section 4 of the act. Section 5 also provides that the violations apply to a "person" rather than a "distributor," so that terminal operators as well as licensed distributors will be covered.

Sections 7 and 8 make conforming changes to the diesel fuel tax laws. Section 7 makes the destination state requirement applicable to shipments of diesel fuel; it deletes the provisions of a statute that duplicate G.S. 105-228.90 and substitutes the destination state requirement for diesel fuel. Section 8 conforms the list of Class 1 diesel fuel tax violations to the list of gasoline tax violations by adding to the list failure to give or show a shipping document when required.

Non-Tax-Paid Fuel Used on the Highways

Diesel fuel is subject to federal and State per gallon excise taxes if it is used to operate a motor vehicle on a highway. Beginning in 1994, the federal government began requiring non-tax-paid diesel fuel, which is supposed to be used only for non-highway uses, to be dyed. Diesel fuel on which the tax has been paid is therefore "clear" diesel because it is not dyed. Under the federal law, it is unlawful to use dyed diesel fuel for a highway use, and a person who operates on a highway a motor vehicle whose supply tank contains dyed diesel fuel is liable for a civil penalty equal to $10 a gallon or $1,000, whichever is greater.

Section 10 of this act makes it a State violation as well as a federal violation to use dyed diesel fuel for a highway use. A person who operates on a highway a motor vehicle whose supply tank contains dyed diesel fuel is guilty of a Class 1 misdemeanor and is liable for a civil penalty. The penalty is the greater of $1,000 or five times the amount of motor fuel tax payable on the fuel in the supply tank. This penalty is in addition to any motor fuel tax assessed.

1994 Chapter 739 (Senate Bill 605, Sen. Seymour)

AN ACT TO EXEMPT WORKS OF ART FOR STATE BUILDINGS FROM STATE AND LOCAL SALES TAXES.

As its title indicates, this act exempts certain works of art from State and local sales and use taxes. The works of art affected are those purchased for State buildings under the State's "Art Works in State Buildings Program," which is set out in Article 47A of Chapter 143 of the General Statutes. The exemption becomes effective September 1, 1994.

The Art Works in State Buildings Program requires that one-half of one percent of the amount appropriated to construct a State building be used to buy works of art for the building. A State building is a building that is to be used by a State agency and is to be constructed or renovated by means of a State appropriation of $1 million or more. A work of art can be sounds, such as the North Carolina sound tape in the Department of Revenue, a mural, such as the one on the side of the Department of Public Instruction's Education Building, or more

traditional art forms such as sculptures or paintings. The only restriction on works of art is that they cannot be reproductions of original art by mechanical means.

This exemption is the second sales and use tax exemption specifically for works of art. G.S. 105-164.13(29) exempts works of art purchased by the North Carolina Museum of Art in whole or in part with money received through gifts or other donations.

The exemption delays the timing but not the amount of revenue received by the State. It does not affect the amount of local sales and use tax paid by the State because the State receives a refund under G.S. 105-164.14(e) of any local sales and use taxes paid. Thus, the act allows the State to retain revenue it would otherwise receive in the form of a refund. The act does not affect the net amount of State revenue because the reduction in the State's cost for the required artwork in State buildings offsets the reduction in State sales and use tax revenue.

The exemption applies to the 2% local sales and use taxes as well as the 4% State sales and use taxes. The exemption from local sales and use taxes results from G.S. 105-467. That statute limits local sales and use taxes to items that are taxed by the State at the general State 4% sales tax rate.

1994 Chapter 745 (House Bill 1725, Rep. Jarrell)

AN ACT TO MAKE TECHNICAL AND CLARIFYING CHANGES TO THE REVENUE LAWS AND RELATED STATUTES, TO IMPROVE THE ADMINISTRATION OF THE SOFT DRINK EXCISE TAX, AND TO EXTEND THE SUNSET OF A TAX CREDIT, TO AMEND THE LAW REGARDING APPLICATION FOR CERTIFICATION AS A CLINICAL SOCIAL WORKER, TO RESTORE THE SOFT DRINK TAX EXEMPTION FOR NATURAL JUICE WITH NO ADDITIVES OTHER THAN VITAMINS, MINERALS, OR SUGAR, AND TO MAKE THE EFFECTIVE DATE OF CHANGES MADE DURING THE 1993 SESSION TO THE CONSUMER CREDIT SALE LAWS RETROACTIVE.

This act makes a number of technical and clarifying changes to various revenue laws and makes four substantive changes in these laws. The act also makes two substantive changes unrelated to revenue laws. The original bill, which consisted only of technical and clarifying changes to various revenue laws and related statutes, was recommended by the Revenue Laws Study Committee.

The first substantive change modifies liability for and payment of the soft drink excise tax. This change allows a person who is not otherwise liable for the tax to assume liability for the tax, effective October 1, 1994. It does this at the request of soft drink taxpayers who would rather be responsible for paying the tax than have to trace the method of shipment of soft drink products they receive in order to determine their liability. This change is expected to be revenue-neutral.

The soft drink excise tax is payable by the person who is the first to bring the product into the State. Who the first person is depends on how the product is brought into the State. If it is brought in by common carrier, the person who receives it is the person to bring it in. If it is brought in on a truck owned or operated by the out-of-state seller of the product, the out-of-state seller is the person to bring it in.

Taxpayers of the soft drink excise who receive products from a person who both transports some products by the person's own trucks and ships others by common carrier often find it difficult to sort out the products for which they are liable and those for which they are not. Sections 32 and 33 create a soft drink certificate of liability that allows a taxpayer to

assume liability for all soft drink products the taxpayer acquires, regardless of their mode of shipment. The act does not change the rate of tax or the total amount of tax payable.

The second substantive change extends the sunset on the corporate and individual income tax credits for constructing a fuel ethanol distillery. Under prior law, the credits were set to expire January 1, 1996. The bill extends the expiration date until January 1, 1998. A credit has never been claimed under these sections. The credit is allowed for 20% of the cost of constructing a distillery to make ethanol, at least 80% of which will be used for fuel for motor vehicles or airplanes, as a de-icer, or in a process that removes pollutants from coal or other sources of fuel. Section 34 extends the corporate credit and Section 35 extends the individual credit.

Sections 36 through 38 make the third substantive change. They prohibit a county from charging a disposal fee for the disposal of a white good while the white goods disposal tax is in effect. A white goods disposal tax is levied on the sale of a white good. The tax is $5.00 if the white good does not contain chlorofluorocarbons and it is $10 if the white good does contain chlorofluorocarbons. Although under prior law a county could not charge an additional fee to dispose of a white good, it could charge whatever fee it levied for the disposal of other types of municipal solid waste. Many taxpayers complained about the disposal fee, which was in addition to the white goods disposal tax. This change became effective August 1, 1994.

The fourth substantive change exempts from the soft drink excise tax juice whose only added ingredients are sugar, vitamins, minerals, or extracts of the juice. These juices were exempt from the excise tax prior to 1991. In 1991, the General Assembly replaced the exemption for soft drinks that contained at least 35% natural fruit juice with an exemption for soft drinks that are 100% natural fruit juice. The definition of "natural" now specifies that a product is not "natural" if it has sugar as an added ingredient.

Under the prior law, bottled juice that would be natural if it did not contain sugar was taxed at the rate of one cent (1¢) per bottle. Juice concentrate that would be natural if it did not contain sugar was taxed at the rate of $1.00 per gallon, or four-fifths of a cent (4/5¢) an ounce. Under the act, both forms of juice are exempt from the tax beginning October 1, 1994. The revenue loss from this exemption is expected to be $1 million in fiscal year 1994-95 and $1.3 to $1.5 million for each fiscal year thereafter. Section 38.2 contains this exemption.

The last two substantive changes are unrelated to the revenue laws. The first of these two changes, made by Section 38.1, extends the deadline that allows a person with experience in clinical social work to apply for certification as a clinical social worker without meeting the educational requirements. Prior to this act, a person with at least one year experience in social work could apply for certification without meeting the educational requirements of the Social Worker Certification Act if the person applied for certification prior to January 1, 1993. This act extends the deadline to include people who applied for certification between December 1, 1993, and January 15, 1994.

The second of these two changes, made by Section 38.3, amends a law enacted by the General Assembly last session. Prior to October 1, 1993, the law required that payments made by a buyer be applied to the purchases bought on credit in proportion to the amount owing on each purchase. Last year, the General Assembly changed the law to reflect the more common accounting practice of applying payments first to finance charges and then to principal in the order that each obligation is assumed. That act, however, did not address how merchants were to apply payments on accounts to which items had been charged prior to October 1, 1993. The implementation problem created by this oversight meant merchants had to bifurcate each

account and divide each payment made so as to apply payments proportionally on items charged before October 1, 1993, and to apply payments on a "first in-first out" basis to charges made after October 1, 1993. This section solves the implementation problem by allowing merchants to treat payments received on or after October 1, 1988, on a "first in-first out" basis if the seller determined, and disclosed to the buyer, that this accounting method would be used at the time the items were charged.

The technical changes are described below by section:

Section	Explanation
1.	Repeals a Session Law that duplicates another Session Law, Section 18 of Chapter 485 of the 1993 Session Laws.
2.	Adds a missing catchline to a subdivision.
3.	Conforms statute to existing administrative practice that soft drink base products are taxed on a per container basis. If a container contains less than the unit measure (a gallon for liquid products and an ounce for dry products), the tax is reduced proportionally.
4.	Reenacts a provision that may not have been rollcalled when originally enacted and corrects a grammatical error.
5.	Clarifies that the deduction described in this subdivision is based on two forms of the same federal adjustment. This change was requested by the Department of Revenue.
6.	Removes an unnecessary cross-reference and a reference to a repealed statute and substitutes a reference to the Code.
7.	Provides an individual income tax deduction to prevent double taxation in cases in which the basis of property for State tax purposes exceeds the basis of property under the Code. For example, individual taxpayers who claim certain federal income tax credits may be required to make a reduction in the basis of their property; if there is no corresponding State tax credit, the basis for State tax purposes will be higher.
8.	Clarifies that the reduction in basis required when a taxpayer takes a tax credit for a qualified business investment applies only if the taxpayer was not required to make a corresponding adjustment under the State corporate income tax.
9.	Deletes a reference to a repealed subsection and clarifies that certain references to "the Secretary" mean the Secretary of State.
10.	Adds a missing catchline.
11.	Makes a language change that was in the 1993 Session Laws but did not go into effect due to a redlining error.
12.	Deletes a word that was inadvertently retained due to a redlining error and modernizes and clarifies language.
13.	Makes conforming changes to reflect the fact that the gasoline and oil inspection fee has been renamed the gasoline and oil inspection tax.
14.	Removes a redundant sentence, adds a catchline, and modernizes and clarifies language.

15. Corrects an incorrect word.

16. Corrects an incorrect term.

17. Removes an obsolete reference to pensions for Confederate soldiers and widows and deletes redundant provisions.

18. Removes language that gives the incorrect impression that there are restrictions on whom a taxpayer is permitted to consult with and clarifies that an interview will not be suspended if the taxpayer is already accompanied by a representative.

19. Makes a conforming change to reflect the fact that the gasoline and oil inspection fee has been renamed the gasoline and oil inspection tax.

20-25. Changes the word "propel" to "operate" to clarify that fuel used to operate a motor vehicle on the highways is equally taxable whether the vehicle is moving or idling.

26. Makes a conforming change to reflect the fact that the gasoline and oil inspection fee has been renamed the gasoline and oil inspection tax and changes the word "propel" to "operate" to clarify that fuel used to operate a motor vehicle on the highways is equally taxable whether the vehicle is moving or idling.

27. Repeals a redundant statute. The substance of this statute is contained in Article 9 of Chapter 105 of the General Statutes, which governs the administration of taxes collected by the Department of Revenue.

28. In 1993, the fees for nonresident malt beverage permits and nonresident wine vendor permits were raised from $25.00 to $50.00. The 1993 legislation failed to make a conforming increase from $25.00 to $50.00 in the fee for a combined nonresident malt beverage and nonresident wine vendor permit. This section makes the conforming increase in the combined permit fee.

29. Makes a conforming change to reflect the fact that the gasoline and oil inspection fee has been renamed the gasoline and oil inspection tax. Also clarifies and modernizes the language of the statute.

30. Deletes a reference to a repealed subsection.

31. Changes a cross-reference to reflect that the powers of a regional economic development commission, formerly listed in a single statute, are now listed in several statutes in Article 2 of Chapter 158 of the General Statutes.

32-38.3 Discussed above.

39. Clarifies that real and personal property belonging to the Woodmen of the World is exempt from property tax under the exemption for fraternal or civic orders and organizations operated for nonprofit benevolent, patriotic, historical, charitable, or civic purposes. This organization is a kind of fraternal order.

40. Provides that the act is effective upon ratification except as otherwise provided: Section 11 becomes effective July 1, 1995, Sections 32 and 33 (soft drink tax liability) become effective October 1, 1994, Section 36 (no white goods fee) became effective August 1, 1994, Section 38 (white goods fee when tax

repealed) becomes effective July 1, 1998, and Section 38.2 (soft drink exemption for certain juice with sugar) becomes effective October 1, 1994.

1994 Chapter 772 (Senate Bill 733, Sen. Sherron)

AN ACT TO ESTABLISH A PARKS AND RECREATION TRUST FUND.

This act is part of a continuing effort to secure additional funds for State and local park needs. It takes a first step towards this goal by establishing the Parks and Recreation Trust Fund as a special revenue fund and by annually appropriating revenue in this Fund to the Department of Environment, Health, and Natural Resources to be used for the State Parks system (75%), matching grants to local units for local parks (20%), and the Coastal and Estuarine Water Beach Access Program (5%). As a special revenue fund, revenue in the new Trust Fund will not revert to the General Fund at the end of a fiscal year and interest and other investment income earned by the Fund will be credited to it. The act is only the first step towards the goal of securing additional funds for State and local park needs because it does not provide a source of revenue for the new Trust Fund. The act is effective upon ratification.

Although the act does not provide a source of revenue for the new Trust Fund, it declares that it is the intent of the General Assembly to dedicate an amount equal to 75% of the State's share of the deed stamp tax imposed by G.S. 105-228.30 to the new Trust Fund and to dedicate an additional 10% of the State's share of this tax to the Recreation and Natural Heritage Trust Fund, which the act renames as the Natural Heritage Trust Fund. To implement this intent, the General Assembly must pass another act making the changes to the use of the deed stamp tax.

The deed stamp tax is an excise tax on instruments transferring real property. It is collected by the register of deeds of the county in which the property is located and is collected when the deed transferring the property is recorded. The tax rate is $1.00 for each $500.00 (0.2%) of the value of the property conveyed. Each county must remit one-half of the net proceeds of the tax to the Department of Revenue. The requirement that each county send one-half of the tax to the State was enacted in 1991 when the State doubled the tax rate from 50¢ for each $500.00 of value to $1.00 for each $500.00 of value and kept the increase.

The Department of Revenue credits 15% of the State's share of the tax to the Natural Heritage Trust Fund and credits the remaining 85% to the General Fund. The State receives approximately $14 million from this tax each year. If the intent language in this act is implemented, the State's share of the tax would be allocated among the new Parks and Recreation Trust Fund (75%), the Natural Heritage Trust Fund (10%), and the General Fund (15%)

1993

Prepared by Cynthia Avrette, Sabra J. Faires, and Martha H. Harris

1993 Chapter 12 (House Bill 81, Rep. Gamble)

AN ACT TO UPDATE THE REFERENCE TO THE INTERNAL REVENUE CODE USED TO DETERMINE CERTAIN TAXABLE INCOME AND TAX EXEMPTIONS.

This act rewrites the definition of the Internal Revenue Code used in various State tax statutes to change the reference date from January 1, 1992, to January 1, 1993, and it corrects an incomplete cross reference to a section of the Internal Revenue Code. Sections 1 through 7 and Sections 9 through 11 change the definition of Code, and Section 8 makes the technical correction. The act is effective for taxable years beginning on or after January 1, 1993.

Updating the reference to the Internal Revenue Code makes recent amendments to the Internal Revenue Code applicable to the State to the extent that State tax law previously tracked federal law. This update has the greatest effect on State corporate and individual income taxes because these taxes are based on federal taxable income and are therefore closely tied to federal law. The franchise tax, gift tax, highway use tax, inheritance tax, insurance company gross premiums tax, and intangibles tax also determine some exemptions based on the provisions of the Code.

Since the State corporate income tax was changed to a percentage of federal taxable income in 1967, the reference date to the Internal Revenue Code has been updated periodically. In discussing bills to update the Code reference, the question frequently arises as to why the statutes refer to the Code as it existed on a particular date instead of referring to the Code and any future amendments to it, thereby eliminating the necessity of periodic updates. The answer to the question lies in both a policy decision and a potential legal restraint.

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

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

Each year, in deciding whether the Internal Revenue Code reference should be updated, the General Assembly considers the changes that have been made to the Code in the past year. No changes were made in the Code in 1992 that affect a tax other than the individual income

tax, and the changes that affect the individual income tax are minor and are not expected to have a significant revenue impact on the State.

The minor changes to the Code were made in the federal Unemployment Compensation Amendments of 1992 and the federal Comprehensive National Energy Policy Act of 1992; no major federal revenue bill was enacted in 1992. Among other changes, these acts extended from December 31, 1995, to December 31, 1996, the date when the federal phaseout of personal exemptions for certain high-income taxpayers was to expire, allow the tax-free roll-over of certain partial distributions from qualified pension plans or qualified annuity plans, modified the monthly amount of employer-provided transportation benefits that is excludable from gross income, and simplified the payment by employers of withheld income taxes.

Recommended by the Revenue Laws Study Committee.

1993 Chapter 45 (House Bill 654, Rep. Baddour)

AN ACT TO EXPAND THE NUMBER OF COUNTIES IN WHICH THE TAX CREDIT FOR CREATING JOBS IS AVAILABLE.

This act makes the following changes in the law:

(1) It expands the existing income tax credit for creating jobs in severely distressed counties by increasing from 33 to 50 the number of counties that are considered severely distressed.

(2) It increases from 33 to 50 the number of counties that can use program income, as well as the number of counties whose cities can use program income, from certain federal block grants to establish revolving loan funds (G.S. 153A-376(f) and G.S. 160A-456(e1)).

The first of these changes is set out in the act. The second change occurs automatically when the class of "severely distressed counties" changes for purposes of the tax credit because the cited statutes are tied to that class. The act is effective for taxable years beginning on or after January 1, 1993.

This act also broadens the number of counties in which local governments are eligible for funds from the Industrial Development Fund, G.S. 143B-437A, to be used for utilities for new or proposed industrial buildings. Any county that is designated as depressed or distressed under the Industrial Development Fund is eligible for funds for utilities for existing industrial buildings; to be eligible for funds for utilities for new or proposed industrial buildings, the county must also be designated as distressed for the purpose of the tax credit. A county that is experiencing major economic dislocation, however, is eligible for funds for utilities for existing, new, or proposed industrial buildings even if it has not been designated as depressed or distressed under either the Industrial Development Fund or the tax credit.

The tax credit is available to businesses that create full-time manufacturing or industrial jobs in a severely distressed county. The credit is $2,800 for each new job. The credit must be taken in four equal installments beginning the year after the new job was created. If the new job does not continue for this four-year period, the part of the credit not yet taken is forfeited. The credit may not exceed 50% of the tax due for a year; the part of a credit that cannot be used because of this limitation can be carried forward for five years.

The fiscal impact of this act will be phased in over four years because the credit is taken in four installments. The Department of Revenue has estimated the annual loss to the General Fund to be as follows:

Fiscal Year	General Fund Loss
1994-95	$0.5 to 1 million
1995-96	$1 to 2 million
1996-97	$1.5 to 3 million
1997-98 & later:	$2 to 4 million

When the tax credit was first enacted in 1987, the number of severely distressed counties was limited to 20. That number was increased in 1989 to 25 and was increased again in 1991 to the present 33.

Because the list of severely distressed counties the Secretary of Commerce gave the Secretary of Revenue for 1993 included only 33 counties, the act directs the Secretary of Commerce to give the Secretary of Revenue by July 15, 1993, a list of the additional 17 counties that will qualify under this act and to determine those counties based on the criteria available when the 33 counties were determined.

As more and more counties qualify for the designation "severely distressed," the name of the designation describes the broader category less accurately. Also, as the credit is expanded to more and more counties, the public purpose of the credit becomes more tenuous.

1993 Chapter 85 (House Bill 920, Rep. Redwine)

AN ACT TO REDUCE THE STATE UNEMPLOYMENT INSURANCE TAX RATE UNDER CERTAIN CIRCUMSTANCES.

This act provides employers who have a credit balance in their unemployment insurance tax account with a 30% reduction in their contribution rate for the remainder of the 1993 calendar year. It also provides these employers with a 30% reduction in their contribution rate for any calendar year in which the balance in the Unemployment Insurance Fund equals or exceeds $800,000,000 as of the preceding August 1. Roughly 80% of the more than 144,000 employers in North Carolina have a credit balance in their account.

The contributions paid by employers go into the Unemployment Insurance Fund. After deducting any refunds payable from the Fund pursuant to G.S. 96-10, the money is deposited with the secretary of the treasury of the United States to the credit of this State's account in the Unemployment Trust Fund. As the money is needed to pay benefits, it is transferred to the State and credited to the benefits account of the State's Unemployment Insurance Fund to be used to pay benefits to people who lose their job through no fault of their own.

North Carolina's account is one of the most solvent accounts of any state in the country. In 1992, the General Assembly was able to suspend the additional unemployment tax collected from employers and credited to the Employment Security Commission Reserve Fund. This Reserve Fund bolsters the Unemployment Insurance Fund. This act goes a step further by lowering the unemployment contribution tax rate for employers with a credit balance in their unemployment insurance tax account.

1993 Chapter 140 (Senate Bill 159, Sen. Kerr)

AN ACT TO PROHIBIT DELIVERY OF NON-TAX-PAID SPECIAL FUEL INTO THE SUPPLY TANK OF A MOTOR VEHICLE AND ACQUISITION OF NON-TAX-PAID SPECIAL FUEL FOR USE IN A MOTOR VEHICLE.

This act creates two related misdemeanor offenses involving the purchase of nontaxpaid special fuel. Special fuel is diesel fuel and other kinds of motor fuel except gasoline. Nontaxpaid special fuel is special fuel on which the per gallon excise tax has not been paid. The two new offenses are knowingly dispensing nontaxpaid special fuel into a motor vehicle and knowingly allowing someone to dispense nontaxpaid special fuel into a vehicle. Both offenses are punishable by imprisonment for up to six months, a fine of up to five hundred dollars, or both. The act becomes effective December 1, 1993.

In addition to creating two misdemeanor offenses, the act makes two technical changes. First, it deletes the word "penalties" in the catchline to G.S. 105-449.34 because the statute contains no penalties other than misdemeanors. Second, it deletes the words "of Revenue" following "Secretary" in two places to apply the definition of Secretary in G.S. 105-449.2. That definition was added in 1991 and a conforming change was not made to this statute.

The misdemeanor offenses created by the act apply only to special fuel rather than to both special fuel and gasoline because of the difference in the application of the per gallon excise tax to these fuels. The per gallon excise tax on special fuel applies to the first sale of the fuel in this State for a highway use; the per gallon excise tax on gasoline applies to the first sale of the gasoline in this State for any use. This difference reflects the difference in the uses of these fuels. Over half of all special fuel sold in this State is used for a purpose other than to propel a motor vehicle, but almost all gasoline sold is used to propel a motor vehicle. The result of these differences is that much special fuel is sold without the per gallon excise tax being collected on the sale. The availability of this nontaxpaid special fuel creates opportunities for tax evasion, a prime example of which is the purchase of nontaxpaid special fuel from nonhighway pumps at service stations.

This act is designed to address the problem of persons buying special fuel from service station pumps marked "Nonhighway Use Only," either with or without the complicity of the service station attendant. The Department discovered this problem during the course of a "sting" operation it conducted in which many retail service stations were caught allowing customers to dispense diesel fuel into motor vehicles from pumps marked "Nonhighway Use Only." In attempting to prosecute those caught, the Department found that although those caught could be assessed a civil penalty under G.S. 105-449.24 or be charged with felony tax evasion, they could not be charged with any misdemeanor offenses. The Department felt that the civil penalty alone was not a sufficient deterrent and that the chance of obtaining felony convictions in these circumstances was unlikely. The Department therefore recommended the creation of these misdemeanor offenses.

Recommended by the Revenue Laws Study Committee.

1993 Chapter 230 (House Bill 936, Rep. Richardson)

AN ACT TO EXPAND THE PROPERTY TAX EXEMPTION FOR NONPROFIT ORGANIZATIONS PROVIDING LOW- AND MODERATE-INCOME HOUSING TO INCLUDE REAL PROPERTY HELD AS A SITE FOR FUTURE LOW- AND MODERATE-INCOME HOUSING.

G.S. 105-278.6 exempts from local property taxes real and personal property belonging to nonprofit organizations that provide housing for people with low or moderate incomes, as long as the property is used exclusively for charitable purposes. This act expands the exemption beginning with the 1994-95 tax year to provide that property belonging to such an organization is considered to be held for a charitable purpose if it is held for no more than five years as a future site for housing for people with low or moderate incomes.

The act provides that the taxes that would otherwise be due on this property become a lien on the property and are deferred. If housing for people with low or moderate incomes is not built on the property within five years after the tax year the exemption is first claimed, the deferred taxes become due, along with interest. The act does not affect State revenues; any revenue loss would be of local government property taxes.

1993 Chapter 255 (House Bill 136, Rep. Barnes)

AN ACT TO EXTEND FOR AN ADDITIONAL FIVE YEARS THE REQUIREMENT THAT COUNTIES USE PART OF THE TWO HALF-CENT LOCAL SALES TAX PROCEEDS ONLY FOR PUBLIC SCHOOL BUILDINGS AND TO CLARIFY THE PROCEDURE BY WHICH A LOCAL GOVERNMENT MAY USE THE TAX PROCEEDS FOR OTHER LAWFUL PURPOSES IF IT CAN PROVIDE FOR ITS PUBLIC SCHOOL AND WATER AND SEWAGE CAPITAL NEEDS WITHOUT RESTRICTING THE TAX PROCEEDS.

There are three Articles of the Revenue Act that authorize counties to levy local sales and use taxes. Article 39 authorizes a one-cent tax, Article 40 authorizes a half-cent tax, and Article 42 authorizes an additional half-cent tax. Article 40, enacted in 1983, and Article 42, enacted in 1986, each provided that for the first ten fiscal years in which the tax was in effect in a county, the county was required to use a percentage of the tax revenue for public school capital outlay purposes (including retirement of outstanding debt). The first ten fiscal years under Article 40 would have ended for most counties in July 1993. This act extends the ten-year periods under both Article 40 and Article 42 for an additional five years. For these five additional years, counties will be required to use 30% of the tax revenue from the first half-cent local sales tax (Article 40) and 60% of the tax revenue from the second half-cent local sales tax (Article 42) only for public school capital outlay purposes. The amount of tax revenue affected by the extension of this requirement is $52.7 million a year. Any local legislation that had already been enacted exempting a county from the restrictions of Article 40 or 42 will remain in effect during the additional five-year period. An example of this type of legislation is Chapter 326 of the 1985 Session Laws, which applies to Burke County.

Articles 40 and 42 also require municipalities to use a percentage of the tax revenue they receive under those Articles for water and sewer purposes. A county or a municipality can, however, petition the Local Government Commission for a waiver of the applicable use restrictions. The Local Government Commission may waive part or all of the restrictions if the county or city demonstrates that its public school capital needs or water and sewer needs, respectively, can be met without the use of the restricted sales tax revenue. This act clarifies the procedure for obtaining a waiver, effective July 1, 1993. First, the petition for a waiver must be in the form of a resolution adopted by the governing body of the county or city. Second, in evaluating the petition, the Local Government Commission is authorized to consider not only the

county's public school capital needs or the city's water and sewer needs, but also the other capital needs of the county or city. The act apparently intends to allow the Local Government Commission to weigh these competing needs and possibly grant a waiver if the other needs are greater than the county's school needs or the city's water and sewer needs. On the other hand, the law still requires the county or city to demonstrate that its school needs or water and sewer needs, respectively, can be provided for without restricting the local sales tax revenue for those purposes.

1993 Chapter 314 (House Bill 57, Rep. Gamble)

AN ACT TO REQUIRE PARTNERSHIPS TO FURNISH EACH PARTNER A COPY OF THE STATE "K-1" TAX FORM.

This act requires a partnership that is doing business in North Carolina to send to each partner enough information about that partner's share of partnership income or loss to enable the partner to file a North Carolina income tax return. The requirement is effective for taxable years beginning on or after January 1, 1993.

Current law requires a partnership that is doing business in North Carolina and is required to file an information return with the Internal Revenue Service to file an information return with the Department of Revenue. Section 6031 of the Internal Revenue Code requires all partnerships except certain nonprofits and partnerships that have gross annual receipts of less than $5,000 to file federal information returns. In addition to requiring an information return, federal law requires a partnership that is required to file an information return to send a statement, known as a K-1, to each partner. The statement sets out the partner's share of the partnership's income or loss. Current State law does not require a partnership to send each partner a similar statement. This act imposes that requirement.

Because each partner gets a federal K-1, the effect of this act is to help nonresident partners file a North Carolina income tax return. A resident partner's partnership income would be included in the partner's federal taxable income that is used as the starting point for computing State taxable income. A nonresident partner, however, who would not normally file a North Carolina income tax return, may not realize that a North Carolina return is required because of the partnership income. Receiving a State K-1 will alert the nonresident partner to the tax liability in this State.

1993 Chapter 315 (House Bill 173, Rep. Luebke)

AN ACT TO PROVIDE THAT THE STATE SHALL PAY INTEREST ON INCOME TAX REFUNDS NOT REFUNDED TO THE TAXPAYER WITHIN FORTY-FIVE DAYS AFTER THE RETURN WAS FILED OR DUE TO BE FILED, WHICHEVER IS LATER.

This act establishes a new rule for determining when the State will pay interest on an overpayment of either corporate or individual income tax and reorganizes and clarifies G.S. 105-266, which governs refunds of all tax overpayments. The new rule became effective upon ratification, July 9, 1993, and applies to overpayments reflected in final returns filed on or after that date. By making this change, the act accomplishes three goals: it establishes the same rule for all overpayments of individual income tax, it establishes the same rule for both corporate and individual income tax, and it makes the State rule for overpayments of income tax the same as the federal rule.

The general rule under G.S. 105-266 that applies to overpayments of any State tax is that interest accrues starting 90 days after the date of an overpayment until a refund is made. Under prior law, two different interest rules applied to overpayments of individual income tax. Overpayments of individual income tax that were not the result of advance payments, made through amounts withheld from wages or from estimated payments, followed the general 90-day rule. Overpayments of individual income tax that were the result of advance payments accrued interest from six months after the later of the date the final return was due or the date the final return was filed. Under prior law, overpayments of corporate income tax followed the general 90-day rule, which makes no distinction between advance payments and other payments for purposes of determining when interest begins to accrue. Therefore, overpayments of corporate income tax made through quarterly estimated payments accrued interest for a large part of the year. This resulted in substantial interest payments each year from the State to corporations that overpaid their estimated income tax.

Under the new rule, interest is payable by the State on an overpayment of corporate or individual income tax 45 days after the latest of the following:

(1) The date the final income tax return was filed.

(2) The date the final income tax return was due.

(3) The date the income tax overpayment was made.

Thus, for overpayments that are the result of advance payments of individual income tax, the bill shortens from 6 months to 45 days the period of time that must elapse before interest begins to accrue. For corporate overpayments made through estimated taxes, the act reduces the length of time that interest will accrue. For excess payments of individual and corporate income tax made with a final return, the act shortens from 90 days to 45 days the period that must elapse before interest begins to accrue.

The federal rule for the accrual of interest on income tax overpayments is the same as the rule established by this act for overpayments of State income tax. Several special rules account for the inevitable delay in processing millions of refunds, for returns that are not processible, and for retroactive application of deductions that create an overpayment for an earlier tax year. Federal law provides that if an overpayment is created by retroactive application of a deduction, the overpayment is considered to have been made on the filing date of the tax year the deduction was created. Federal law also provides that a return is not considered filed until it is in processible form. The State rule established by this act incorporates these special rules.

Recommended by the Revenue Laws Study Committee.

1993 Section 26 of Chapter 321 (House Bill 134, Rep. Nesbitt, and Senate Bill 48, Sen. Perdue)

LOCAL FINANCIAL SECURITY.

Section 26 makes significant changes concerning the distribution of State tax revenue to local governmental units. Most importantly, it converts the distribution to local units of State-shared tax revenue from an annual appropriation to an earmarking of current tax collections and removes the current "growth-freeze" on State-shared tax revenue. It also changes the timing of the distribution of State-shared intangibles tax revenue and beer and wine tax revenue, changes the timing of the State reimbursements to local units for the repeal

of local property taxes on inventories and on poultry and livestock, and changes the source of funds for the State reimbursement to local units for the repeal of the intangibles tax on money on deposit and the modification of the intangibles tax on accounts receivable. The change in the source of funds for the intangibles tax reimbursement became effective July 9, 1993. The remaining changes become effective July 1, 1995.

State-shared tax revenue is tax revenue distributed by the State to local units based on collections of the State tax on intangible personal property, the State excise taxes on beer and wine, and the State corporate franchise tax on electric power companies, natural gas companies, and telephone companies. These revenues are sometimes referred to by local units as "State-collected local revenues" even though they are a part of State tax revenues because the State has traditionally shared its revenues from the intangibles tax, the beer and wine taxes, and the utility franchise tax with local units.

State-shared tax revenue is sometimes confused with State reimbursements to local units, but the two are distinct. State reimbursements are amounts distributed to local units to compensate them for revenue lost as a result of the removal by the General Assembly of property from the local sales and use tax base, the local property tax base, or the intangibles tax base. State reimbursements consist of reimbursements for the repeal of the property tax on inventories, the repeal of the intangibles tax on money on deposit, the modification of the intangibles tax on accounts receivable, the repeal of the property tax on poultry and livestock, the "homestead exemption" from property tax, and the repeal of local sales and use taxes on food purchased with food stamps. This act changes the timing and source of two of the reimbursements but does not restore growth in any State reimbursement or otherwise change the amount of any State reimbursement.

Earmarking of State-shared Revenue

Before fiscal year 1989-90, State-shared tax revenue was earmarked rather than appropriated annually. Earmarking refers to the accrual method of accounting for the amount of State-shared tax revenue to be distributed, by which the amount is put in a liability reserve account of the State and then automatically disbursed on the specified date. In 1990, the General Assembly changed the accounting treatment of State-shared tax revenue from an earmarking, which is an accrual accounting method, to an annual appropriation, which is a cash accounting method. The reason for the change was to balance the 1989-90 State budget on a financial basis by removing approximately $140 million from liability reserves. Consequently, the State appropriation act for fiscal year 1990-91 and each subsequent year has included an appropriation to local units of the State-shared tax revenue.

Effective with the 1995-96 fiscal year, paragraphs (a), (g), (h), and (i) of section 26 restore the earmarking method of accounting for distributions of State-shared tax revenue, once again making the distribution an automatic "off-budget" transfer. As an "off-budget" transfer, the distribution will not appear in the appropriations act for fiscal year 1995-96 and subsequent years and is thereby removed from annual legislative scrutiny during the budget process and from the possibility of reduction by the Governor, acting under Article III, 5(3) of the North Carolina Constitution, to prevent a deficit for a fiscal year.

Removal of Growth Freeze in State-shared Revenue

In addition to restoring the prior accounting method used for State-shared tax revenue, Section 26 also restores the prior method for determining how much revenue is to be shared, with one important difference. That difference is a deduction for the growth freeze in this revenue in effect for distributions made from July 1, 1991, up to July 1, 1995.

Under Section 26, the State-shared tax revenue base consists of the following: (i) the amount of intangibles tax collected, less the four-year growth freeze for the tax and the State's cost in collecting the tax, in hearing property tax appeals, in providing a few property-tax related courses at the Institute of Government in Chapel Hill, and in operating the Local Government Commission; (ii) 23 3/4% of the State excise tax on beer; (iii) 62% of the State excise tax on unfortified wine; (iv) 22% of the State excise tax on fortified wine; and (v) the amount of the State franchise tax on electric power companies, natural gas companies, and telephone companies that equals 3.09% of the taxable gross receipts derived by these companies from sales of electricity, natural gas, and telephone service within cities, less the four-year growth freeze for the tax. Except for the growth-freeze deduction, this base is almost identical to the pre-growth freeze base. That previous base, however, did not deduct the cost of the Local Government Commission from intangibles tax collections; this deduction was first made in fiscal year 1991-92.

As did the pre-growth freeze State-shared revenue base, the base in Section 26 will vary from year to year as total collections of the specified taxes change. Consequently, if total collections of the specified taxes increase, the amount distributed to local units will increase and if total collections decrease, the amount distributed to local units will decrease.

Under current law, State shared-tax revenue is a fixed $237 million. This amount is based on fiscal year 1989-90 intangibles tax collections, collections of beer and wine taxes from October 1, 1989, through September 30, 1990, and collections of the utility franchise tax from April 1, 1990, through March 31, 1991. Although the benchmark period for each tax differs, the result is that all distributions of these taxes made in fiscal years 1991-92 through 1994-95 are frozen and distributions of taxes made in other fiscal years are not frozen.

The General Assembly froze the amount of State-shared tax revenue to be distributed to local units beginning in fiscal year 1991-92. For that year and subsequent fiscal years, the frozen amount was $237 million. This amount was the same amount of State-shared tax revenue the General Assembly appropriated to local units in fiscal year 1990-91, which was the first year State-shared revenue was appropriated rather than earmarked, and included the growth in the revenue. Local units received 6.2% less in fiscal year 1990-91 than the General Assembly appropriated, however, because the Governor reduced the appropriation as part of the effort to balance the State budget for that year. For the 1991-93 fiscal biennium, the total growth freeze was $35.2 million. By the time the growth freeze ends on July 1, 1995, the total growth freeze amount is expected to grow to between $55 and $60 million.

Effective for the 1995-96 fiscal year, paragraphs (a), (g), (h), and (i) of Section 26 remove the growth freeze but require distributions of intangibles tax collections and utility franchise tax collections to be reduced by the growth freeze amount for these taxes. The section does not require a growth freeze deduction from the distribution based on beer and wine tax collections because those collections have not grown significantly since the freeze went into effect.

The growth freeze amount for the intangibles tax is the difference between the amount of intangibles tax collected during the 1993-94 fiscal year and the 1989-90 fiscal year. State-shared intangibles tax is distributed to local units once a year. Therefore, the growth freeze amount for this tax will be deducted annually from intangibles tax collections in calculating the amount to be distributed to local units.

The growth freeze amount for the utility franchise tax is the difference between the amount of utility franchise tax collected for the period April 1, 1994, to March 31, 1995, and

the period April 1, 1990, to March 31, 1991. State-shared utility franchise tax is distributed to local units in four quarterly payments. Therefore, one-fourth of the annual growth freeze amount for this tax will be deducted from utility franchise tax collections in calculating the quarterly amount to be distributed to local units.

The amount of State-shared tax revenue estimated to be distributed to local units in fiscal year 1995-96 is $255 million. The growth freeze deduction for that year is expected to be between $55 and $60 million.

Timing Changes in Distributions of State-shared Revenue and Reimbursements

When the switch from appropriating State-shared revenue to earmarking it becomes effective in fiscal year 1995-96, the State will once again put the revenue in a liability reserve account as it is collected and hold it for subsequent distribution to local units. The amount put in a reserve account will no longer be available for appropriation and will be a liability on the State's balance sheet rather than an asset. Therefore, to the extent State-shared tax revenue is collected in one fiscal year for distribution in the next fiscal year, the State must carry the reserve over from one fiscal year to the next.

To avoid having to suddenly reserve over $120 million in the 1994-95 fiscal year to make the distribution of State-shared intangibles tax revenue in August of the 1995-96 fiscal year, which would put the State's balance sheet for fiscal year 1994-95 out of balance, paragraph (a) of the section changes the timing of the intangibles tax distribution from August of one calendar year to June 25 of the following calendar year and changes the collection period used for making the distribution from the previous fiscal year to July 1 through April 30 of the same fiscal year. This change in distribution date and collection period puts the collection and distribution of the intangibles tax within the same fiscal year and means that the June 25 distribution of State-shared intangibles tax revenue will be made from intangibles tax revenue collected in the same fiscal year the distribution is made. To ensure that local units receive an amount equivalent to what they would receive if the collection period were 12 months instead of 10 months, paragraph (a) sets the starting amount to be used in calculating the distribution at 103% of collections rather than 100%.

The distribution date and collection period established by paragraph (a) for State-shared intangibles tax revenue differs from the distribution date and collection period used for the tax before fiscal year 1990-91, when the tax was also earmarked rather than appropriated. In the pre-1990-91 system, intangibles tax revenue collected in one fiscal year, largely in April of each year, was put in a reserve and distributed in August or September of the next fiscal year.

Paragraph (g) of this section makes a similar change to the distribution date and collection period for State-shared beer and wine tax revenue. It changes the distribution date from within 60 days after September 30 of one calendar year to within 60 days after March 31 of the next calendar year, and changes the collection period on which the distribution is based from the 12-month period ending September 30 to the 12-month period ending March 31. This change reduces the amount of beer and wine taxes the State must reserve from one fiscal year to the next and delays the distribution to local units.

Delaying the distribution date for State-shared intangibles tax revenue delays the receipt of these funds by local units by almost 10 months, and delaying the distribution date for State-shared beer and wine taxes delays the receipt of these funds by local units by 6 months. To mitigate the cash-flow impact on local units from these delays, paragraphs (b) through (f) of this section move the distribution of 60% of the reimbursement for the repeal of property taxes

on inventories and on poultry and livestock from April of one calendar year to August of the preceding calendar year. There is no accounting impact from splitting this reimbursement distribution into two distributions because the reimbursements are currently earmarked out of current-year revenues and both reimbursements stay within the same fiscal year. Under current law, local units receive 100% of the inventory tax reimbursement and of the poultry and livestock reimbursement in April of each year. Beginning in fiscal year 1995-96, local units will receive 60% of the money in August of a fiscal year and the remaining 40% in April of the same fiscal year.

Source of Funds For Reimbursement For Modification and Partial Repeal of Intangibles Tax

Paragraph (k) of Section 26 changes the source of tax revenue used to reimburse local units for the repeal of the intangibles tax on money on deposit and the revision of the intangibles tax on accounts receivable. The source is changed from corporate income tax collections to individual income tax collections. The change was made at the request of the Office of State Controller. That Office requested the change because this reimbursement distribution is made in August and during that month the State typically has enough individual income tax collections to cover the distribution but does not have enough corporate income tax collections to cover the distribution.

Recommended by the Joint Select Fiscal Trends and Reform Study Commission.

1993 Chapter 360 (House Bill 105, Rep. R. Smith)

AN ACT TO INCREASE THE PROPERTY TAX HOMESTEAD EXEMPTION AMOUNT FROM TWELVE THOUSAND DOLLARS TO FIFTEEN THOUSAND DOLLARS AND TO MAKE TECHNICAL CHANGES TO THE HOMESTEAD EXEMPTION STATUTES.

This act increases the homestead exemption amount from $12,000 to $15,000 and makes numerous technical changes to the homestead exemption statutes. The act becomes effective for taxable years beginning on or after July 1, 1994.

The homestead exemption is a partial exemption from property taxes for the residence of a person who has an income of less than $11,000 and is either age 65 or older or totally disabled. The current exemption amount is $12,000. The exemption was last increased in 1987, when it was increased from $10,000 to $12,000. The technical changes made in the act are as follows:

(1) Changes the statutory citation in the definition of income because the statute cited in the current law was repealed in 1989.

(2) Adds a definition of Internal Revenue Code to the list of defined terms.

(3) Puts the definitions in alphabetical order.

(4) Makes the statutes gender neutral.

(5) Changes the reference from mobile homes to manufactured homes.

(6) Removes substantive provisions from the definition section and places them in the appropriate places.

(7) Conforms the use of the terms "permanent residence" and "exclusion" so that they are used consistently throughout the statutes.

(8) Changes the property tax information sheet and the abstract to reflect the changes to the homestead exemption amount.

The revenue loss associated with this act will be a loss to the general funds of local governments. Prior to 1991, the State reimbursed counties and cities for 50% of their losses from the homestead exemption. In 1991, the General Assembly froze the amount of reimbursements made to local governments at the amount each city and county was entitled to receive in fiscal year 1990-91.

1993 Chapter 362 (House Bill 509, Rep. Griffin)

AN ACT TO RAISE THE INHERITANCE TAX FILING THRESHOLD.

This act provides that an inheritance tax return does not need to be filed for an estate whose beneficiaries are all Class A beneficiaries, the surviving spouse, or both, if the gross value of the estate is less than $450,000. The act applies to estates of decedents dying on or after July 1, 1993. Under prior law, a return had to be filed in these circumstances if the gross value of the estate was $250,000 or more. This act is not expected to have any impact on State revenues.

Property passing to a surviving spouse is exempt from inheritance tax. Property passing to Class A beneficiaries (lineal ancestors and descendants) is entitled to an inheritance tax credit of $26,150; this credit amount effectively exempts approximately $500,000 in value of an estate that passes to Class A beneficiaries. Under former law, an estate that passed to the spouse, Class A beneficiaries, or both was required to file an inheritance tax return with the Secretary of Revenue if the value of the estate was $250,000 or more, even though no tax would be required if the value of the estate was under $500,000. This act will relieve more beneficiaries from this filing requirement by increasing the threshold to $450,000. The filing threshold remains below $500,000, however, to allow the Department of Revenue to review inheritance tax returns of larger estates to determine whether the value placed on the estate's assets is understated.

1993 Chapter 364 (House Bill 1274, Rep. Gamble)

AN ACT TO PROVIDE THAT THE EXEMPTION FROM THE SCRAP TIRE TAX FOR TIRES SOLD FOR PLACEMENT ON NEWLY MANUFACTURED VEHICLES SHALL APPLY UNIFORMLY REGARDLESS WHEN THE TIRES WERE SOLD.

This act grants a retroactive scrap tire tax exemption to new tires placed on newly manufactured vehicles, gives anyone who paid tax on tires that are exempted by the act additional time to claim a refund for the tax paid, and restricts the amount of interest payable by the State on a refund. The act became effective July 16, 1993.

The exemption granted by the act applies to the period beginning January 1, 1990, and ending July 15, 1992. This is the period from the effective date of the tax to the date these tires were exempted from the tax by Chapter 867 of the 1991 Session Laws (Reg. Sess. 1992).

A refund for taxes paid during this period may be claimed at any time before July 1, 1994. Interest payable on a refund accrues at the rate of 5% a year instead of at the rates that would otherwise apply. The rates that would otherwise apply are 9% for calendar years 1990 and 1991, 8% for calendar year 1992, and 7% for calendar year 1993 and subsequent

calendar years. Interest accrues on a refund of the scrap tire tax starting 90 days after an overpayment of the tax until the refund is made.

Proponents of this act argued that the scrap tire tax was never intended to apply to new tires placed on newly manufactured vehicles. Whether or not this was the intent, however, the tax by its terms did apply to new tires purchased for placement on newly manufactured vehicles from its effective date of January 1, 1990, until the exemption became effective on July 15, 1992.

Currently, the scrap tire disposal tax is a 1% tax on the price of certain tires. Effective October 1, 1993, the tax rate will increase to 2% on tires having a bead diameter of less than 20 inches and will remain at 1% for all other tires. Most of the revenue from the tax is used to pay for the disposal of scrap tires or the abatement of a nuisance caused by storing scrap tires.

The scrap tire tax was first enacted in 1989 and was revised by Chapter 221 of the 1991 Session Laws. When first enacted, the tax applied to new motor vehicle tires sold at retail and the regular exemptions from sales tax did not apply to sales of the tires. Thus, the exemption for items that are component parts of a manufactured product did not apply and tires purchased for placement on newly manufactured vehicles were subject to the tax. The 1991 revision did not change the taxation of new tires placed on newly manufactured vehicles.

After the 1991 Session, several manufacturers of vehicles, including Freightliner and Caterpillar, asked the Revenue Laws Study Committee to study the issue of the taxation of new tires purchased for placement on newly manufactured vehicles. The Committee concluded that taxation of these tires was contrary to the intent of the tax and placed North Carolina-made vehicles at a competitive disadvantage to vehicles made in other states. The Committee therefore recommended that new tires placed on newly manufactured vehicles be exempted from the tax and that the exemption apply retroactively.

In its 1992 regular session, the General Assembly enacted the recommendation of the Revenue Laws Study Committee to exempt from the scrap tire tax new tires placed on newly manufactured vehicles. It did not enact that Committee's recommendation to make the exemption retroactive. This act, however, makes the exemption retroactive.

The Revenue Laws Study Committee found that the intent of the scrap tire disposal tax is to tax a tire that replaces a tire that is removed from a vehicle and is therefore in need of disposal. Obviously, when a new tire is placed on a newly manufactured vehicle, no tire is being replaced and no tire is in need of disposal.

1993 Chapter 371 (Senate Bill 158, Sen. Kerr)

AN ACT TO PROVIDE THAT THE PENALTY FOR FAILURE TO FILE AN INHERITANCE TAX RETURN WILL BE ASSESSED AND COLLECTED IN THE SAME MANNER AS THE PENALTY FOR FAILURE TO PAY INHERITANCE TAXES.

This act makes the procedure for collecting the existing penalty for failure to file an inheritance tax return the same as the procedure for collecting the penalty for failure to pay inheritance taxes or other taxes, specifies that the penalty for failure to file does not apply if there is no inheritance tax due on the estate, and makes several technical changes to the affected statute. The act is effective for the estates of decedents dying on or after October 1, 1993. The act is expected to result in a minimal increase in General Fund revenues.

The penalty for failure to file an inheritance tax return is $500. The penalty is payable by the personal representative. This act changes the collection procedure for this penalty by deleting the sentence in former law that required the penalty to be collected by filing a suit in the Wake County Superior Court. By deleting this sentence, the penalty will become subject to the general administrative provisions of Article 9 of the Revenue Act and become collectible in accordance with those provisions. Under Article 9, penalties are collectible in the same manner as taxes: the Department of Revenue proposes an assessment and the taxpayer has the right to contest the assessment through standard administrative procedures before appealing to the court system.

The requirement that the inheritance tax penalty be recovered in an action brought in the superior court of Wake County is unique to that penalty and is an historical anachronism. The general collection provisions in Article 9 were enacted in 1949 but the inheritance tax law was enacted before that date. The procedure for collecting the inheritance tax penalty was not changed to conform to the general provisions in 1949.

This act also makes several technical changes. It substitutes the general term "personal representative" for the terms "administrator" and "executor" that appear in G.S. 105-23. It deletes an incorrect cross-reference to G.S. 105-2(a)(3), and it deletes obsolete provisions. One of the obsolete provisions deleted is the requirement that the inheritance tax return state the ages of any minor children of the decedent. That requirement dates back to the time exemptions were allowed against the taxable estate; some of the exemptions were based upon the ages of any beneficiaries who were children of the decedent. This exemption provision was replaced with the current inheritance tax credit in 1977.

Recommended by the Revenue Laws Study Committee.

1993 Chapter 372 (Senate Bill 183, Sen. Kerr)

AN ACT TO PROVIDE THAT A SALES TAX LICENSE IS VOID IF THE RETAILER REPORTS NO SALES FOR EIGHTEEN MONTHS.

This act provides that a sales tax license becomes void if the licensed retailer reports no sales for a period of 18 months. The act became effective August 1, 1993.

All sales of tangible personal property are presumed to be taxable (G.S. 105-164.26). A sale is not taxable if the buyer intends to resell the property. A person who sells property in a wholesale sale can negate the presumption that the sale is taxable by checking the buyer's certificate of resale. A certificate of resale states that the property bought is for resale, states the buyer's sales tax license number, and indicates the type of property the buyer sells in the regular course of business.

In 1992, the Revenue Laws Study Committee received complaints from taxpayers about individuals who acquire a sales tax license and then fraudulently give a certificate of resale when purchasing property they have no intention of reselling. The Committee found no hard data indicating the extent to which this type of tax evasion occurs. The Committee felt that tax evaders would be deterred by a new penalty enacted in 1992 upon the recommendation of the Revenue Laws Study Committee. Chapter 914 of the 1991 Session Laws (1992 Session) added an additional penalty of $250 to be assessed by the Secretary of Revenue against a buyer who misuses a certificate of resale, effective July 10, 1992.

A sales tax license is required of every person who engages in the retail or wholesale business. The license costs $15 and, once issued, remains valid unless the license holder remains

continuously out of business for five years. The Committee noted that increasing the $15 license fee or requiring periodic renewal of licenses would place a burden on the many legitimate small retailers and have only a small impact on potential tax evaders. The Committee decided that the State could limit the number of non-retailers who obtain licenses for fraudulent purposes by providing that a license becomes void if the license holder makes no sales for an 18-month period. The Committee felt that all legitimate merchants would make at least some sales every 18 months. This act implements the Committee's recommendation. The act provides an exception for wholesalers and for license holders who make only exempt sales. The latter group includes civic organizations and other nonprofit associations who occasionally sell items to raise funds; these license holders may go for long periods between fund-raising sales.

Recommended by the Revenue Laws Study Committee.

1993 Chapter 400 (House Bill 681, Rep. DeVane)

AN ACT TO IMPLEMENT THE REQUIREMENTS OF THE 1990 AMENDMENTS TO THE FEDERAL CLEAN AIR ACT, TO REPEAL THE EXPIRATION OF A PORTION OF THE PER GALLON FUEL TAX, TO DEDICATE A PORTION OF THE PROCEEDS OF THE TAX TO THE ADMINISTRATION OF THE AIR QUALITY PROGRAM, TO DEDICATE A PORTION OF THE PROCEEDS OF THE TAX TO THE CLEANUP OF LEAKING PETROLEUM UNDERGROUND STORAGE TANKS, AND TO REPEAL THE EXPIRATION OF THE LEAKING PETROLEUM UNDERGROUND STORAGE TANK CLEANUP ACT OF 1988.

This act changes various procedures concerning the issuance and enforcement of air quality permits to conform State law on this subject to the 1990 amendments to the federal Clean Air Act, repeals the 1995 scheduled reduction in and the 1999 repeal of the additional 1/2¢ a gallon motor fuel tax that became effective January 1, 1992, and changes the distribution of this additional 1/2¢ motor fuel tax. The conforming air quality permit changes and the repeal of the scheduled reduction in and the repeal of the additional 1/2¢ motor fuel tax became effective July 19, 1993. The change in the distribution of the additional 1/2¢ a gallon motor fuel tax becomes effective January 1, 1995.

The 1991 General Assembly increased the motor fuel per gallon excise tax by 1/2¢ a gallon effective January 1, 1992. The increase applies to the tax on gasoline imposed by Article 36 of Chapter 105 of the General Statutes, to the tax on diesel fuel and other special motor fuel imposed by Article 36A of that Chapter, and to the road tax imposed by Article 36B of that Chapter on motor carriers who purchase fuel outside the State for use inside the State.

The purpose of the additional 1/2¢ a gallon tax increase was to provide funds to clean up the environmental damage caused by leaking underground petroleum storage tanks. One-half of the revenue from this additional tax is therefore credited to the Commercial Leaking Underground Petroleum Storage Tank Cleanup Fund, established under G.S. 143-219.94B, and the remaining half is credited to the Groundwater Protection Loan Fund, established under G.S. 143-215.94P.

In the act that imposed the additional 1/2¢ a gallon tax, the 1991 General Assembly reduced the tax to an additional 1/4¢ tax effective January 1, 1995, directed how the reduced tax was to be distributed, and then repealed the reduced tax effective January 1, 1999. All of the proceeds of the reduced January 1, 1995, tax were to be credited to the Commercial Leaking Underground Petroleum Storage Tank Cleanup Fund. Sections 11 and 12 of this act

repeal the scheduled 1995 reduction in and the scheduled 1999 repeal of the additional 1/2¢ tax, thereby making the 1992 increase a permanent increase.

Section 13 of this act changes the distribution of the now permanent additional 1/2¢ a gallon motor fuel tax. Effective January 1, 1995, the proceeds of the additional tax will be distributed as follows: 19/32 to the Commercial Leaking Petroleum Underground Storage Tank Cleanup Fund, 3/32 to the Noncommercial Leaking Petroleum Underground Storage Tank Cleanup Fund, and 5/16 to the Water and Air Quality Account within the Department of Environment, Health, and Natural Resources. Thus, the Commercial Leaking Petroleum Underground Storage Tank Cleanup Fund will receive slightly more of the 1/2¢ tax than it is currently receiving, the Groundwater Protection Loan Fund will receive no revenue from the additional tax, and the Noncommercial Leaking Petroleum Underground Storage Tank Cleanup Fund and the Air and Water Quality Account will begin to receive revenue from the additional tax.

The proceeds credited to the Water and Air Quality Account must be used for the air quality program. This restriction ensures that the additional tax proceeds will continue to be used for environmental programs that address problems created by the use of motor fuels. Air quality programs are related to problems created by the use of motor fuels because motor vehicle emissions contribute significantly to air pollution.

1993 Chapter 424 (Senate Bill 787, Sen. Kerr)

AN ACT TO IMPOSE A PENALTY FOR FAILURE TO COMPLY WITH ESC TAX REPORTING REQUIREMENTS.

This act imposes two new penalties for failure to comply with certain reporting requirements of the Employment Security Commission. It imposes a penalty on an employer with 250 or more employees who does not file on magnetic tapes or diskettes that portion of the "Employer's Quarterly Tax and Wage Report" that contains the name, social security number, and gross wages of the employees. The penalty will be $25. It also imposes a penalty on an agent of employers who does not file the required information on magnetic tape or diskette if the agent files the report for 250 or more employees of one or more employers. In this case, the penalty will not be monetary. Instead, the law will prohibit that agent from reporting wages and filing reports with the Employment Security Commission on behalf of the subject employees for a period of one year. The Commission may reduce or waive a penalty against either an employer or an agent for good cause shown. The act becomes effective September 30, 1995, and applies to Employer's Quarterly Tax and Wage Reports required to be filed on or after the quarter ending September 30, 1995.

The Commission began requiring the filing of this report on magnetic tape or diskette in 1992 because of an act passed by the General Assembly in 1991. The large employers subject to this requirement are currently required to file this information on tape with the federal government. The purpose of the requirement is to speed up reporting and make it more efficient. Current law does not contain an appropriate penalty for an employer or an agent who does not file the report in the correct manner. At the present time, the Commission considers a report that is not filed correctly as not being filed. The penalty for failure to file is 5% of the tax for each month that the report is not filed, not to exceed 25% of the aggregate or $5 per month, whichever is greater. The majority of the more than 152,000 employers subject to this requirement have complied. In the approximately 400 cases where the requirement has not been met, the Commission has waived the failure to file penalty that it believes it could impose.

1993 Chapter 432 (House Bill 720, Rep. G. Miller)

AN ACT TO INCREASE THE INCOME TAX CREDIT FOR CHILD AND DEPENDENT CARE EXPENSE FOR FAMILIES WITH INCOME BELOW FORTY THOUSAND DOLLARS A YEAR.

This act increases the income tax credit for child and dependent care expenses for families with income below $40,000 a year. Under current law, the credit is based on a flat percentage of the child and dependent care expenses claimed on the taxpayer's federal tax return. Effective for taxable years beginning on or after January 1, 1994, the credit will be based upon income and filing status. The act will lower General Fund revenues by $3.7 million in fiscal year 1994-95 and by $4 million in fiscal year 1995-96.

Under current law, a taxpayer may claim a tax credit equal to 7% of the federal employment-related expenses for dependents who are seven years old or older and 10% for dependents who are either under the age of seven or are physically or mentally incapable of caring for themselves. Under this act, the applicable percentages will range from 7% to 9% for dependents who are seven years old or older and 10% to 13% for dependents who are either under the age of seven or are physically or mentally incapable of caring for themselves. The act also equalizes the value of the credit among the taxpayers with a different filing status.

The act does not increase the maximum credit amount allowed. The credit may not exceed $2,400 if the taxpayer's household includes one qualifying individual and it may not exceed $4,800 if the taxpayer's household includes more than one qualifying individual.

The actual percentages allowed under this act are as follows:

Filing Status	Adjusted Gross Income	Dependents age 7 or older, not disabled	Other Dependents
Head of Household	Up to $20,000	9%	13%
	Over $20,000		
	Up to $32,000	8%	11.5%
	Over $32,000	7%	10%
Surviving Spouse or Joint Return	Up to $25,000	9%	13%
	Over $25,000		
	Up to $40,000	8%	11.5%
	Over $40,000	7%	10%
Single	Up to $15,000	9%	13%
	Over $15,000 up to $24,000	8%	11.5%
	Over $24,000	7%	10%
Married Filing Separately	Up to $12,500	9%	13%

Over $12,500 Up to $20,000	8%	11.5%
Over $20,000	7%	10%

1993 Chapter 433 (House Bill 843, Rep. Gamble)

AN ACT TO REQUIRE THE DEPARTMENT OF REVENUE TO INCLUDE IN ITS BIENNIAL TAX EXPENDITURE REPORT ESTIMATES OF THE AMOUNT BY WHICH EACH TAX EXPENDITURE REDUCES STATE REVENUES AND TO SEND A COPY OF THE REPORT TO EACH LEGISLATOR.

This act requires the Secretary of Revenue to include in the biennial tax expenditure report prepared by the Department of Revenue an estimate of the amount by which revenue is reduced by each tax expenditure. A tax expenditure is an exemption, an exclusion, a deduction, an allowance, a credit, a refund, a preferential tax rate, or another device that reduces the amount of tax revenue that would otherwise be available to the State. Under prior law, an estimate of the revenue loss was not required if making the estimate would impair other duties of the Secretary or the Department. The availability of the actual tax costs of the tax expenditures will better enable the General Assembly to scrutinize and evaluate the costs and benefits of these expenditures. The act also requires the Secretary to give each member of the General Assembly a copy of the tax expenditure report. Under prior law, members received copies of the report only upon request.

The Department of State Treasurer has suggested that, for the tax expenditure report to be an effective tool, "it needs to be carried further, and upgraded to include the actual tax costs of the many preferences; and it needs both legislative and public scrutiny." This act seeks to enhance the effectiveness of the biennial tax expenditure report by making it more complete and by making it more accessible to the members of the General Assembly.

1993 Chapter 440 (Senate Bill 162, Sen. Kerr)

AN ACT TO LIMIT THE NUMBER OF MOTOR VEHICLE DEALER LICENSE PLATES THAT CAN BE ISSUED TO THE SAME DEALER, TO MODIFY THE SANCTIONS FOR MISUSE OF A DEALER LICENSE PLATE, TO EXPAND THE USE OF TRANSPORTER PLATES, TO ESTABLISH A SPECIAL SPORTS EVENT TEMPORARY PLATE, AND TO CHANGE THE FEES FOR DEALER PLATES AND TRANSPORTER PLATES.

This act makes the changes described in its title and also makes numerous administrative and technical changes. The dealer plate changes and the authorization for the new special sports event temporary plate become effective October 1, 1993. The transporter plate changes become effective January 1, 1994. Sections 2, 3, and 7 through 12 make the dealer plate changes, Sections 4 through 6 make the transporter plate changes, Section 13 authorizes the new sports event temporary plate, and Section 1 makes an unrelated technical change.

The purpose of the act is to prevent the misuse of motor vehicle dealer license plates. The act does this by restricting the number of dealer license plates that can be issued to the same dealer, expanding the allowable uses of transporter plates so that fewer dealer plates are needed, and creating a new sports event temporary plate that can be used by dealers who provide vehicles for athletic events.

The misuse of a dealer license plate occurs when a dealer in new or used motor vehicles allows a dealer license plate to be used on a motor vehicle that is not, for all practical purposes, part of the inventory of the dealer. The General Assembly is concerned about this problem because a motor vehicle that is improperly driven with a dealer license plate escapes property taxes, escapes motor vehicle title and registration fees, and receives an unfair advantage on automobile insurance. It escapes property taxes because it is supposedly part of the inventory of the dealer and is, therefore, exempted from property tax by the exemption for inventory. It escapes motor vehicle title and registration fees because the title to the vehicle has not been transferred to the person who uses the vehicle. It enjoys an unfair advantage on insurance because it is insured through the dealer's blanket liability insurance policy rather than through a policy that is specific to the vehicle.

Dealer Plate Changes

The most important change the act makes is to limit the number of dealer plates that can be issued to the same motor vehicle dealer. Until October 1, 1993, a dealer can obtain an unlimited number of dealer plates by submitting an application to the Division and paying the $10 fee for each plate. After October 1, 1993, a dealer can obtain no more than the maximum number of plates authorized by a schedule that is based on a combination of the number of motor vehicles the dealer sold during the relevant twelve-month period and the average number of qualifying sales representatives employed by the dealer during that period. The number of plates the schedule authorizes is as follows:

Vehicles Sold In Relevant 12-Month Period	Maximum Number of Plates
Fewer than 12	1
At least 12 but less than 25	4
At least 25 but less than 37	5
At least 37 but less than 49	6
49 or more	At least 6, but no more than 4 times the average number of qualifying sales representatives employed by the dealer during the relevant 12-month period.

The relevant 12-month period is the most recent 12-month period ending April 30. A "qualifying sales representative" is a sales representative who works for the dealer at least 25 hours a week on a regular basis and is compensated by the dealer for this work.

The act makes special allowances for new dealers as well as for established dealers who, for the first time, sell at least 49 vehicles in a year. A new dealer who was not in business for part or all of the relevant 12-month period may obtain the number of plates that equals four times the number of qualifying sales representatives employed by the dealer on the date the dealer files the application for dealer plates. An established dealer who was in business during the relevant 12-month period, who sold fewer than 49 vehicles during that period, but who has sold at least 49 vehicles since May 1 may apply for additional plates and may receive the number of plates that equals four times the average number of qualifying sales representatives employed by the dealer during the relevant 12-month period.

Although the act limits the number of dealer plates a dealer can obtain, the act preserves the open-ended use of the plates by officers and employees of the dealer, with one new restriction. The act prohibits an employee of the dealer who is less than 18 years old from driving a vehicle bearing a dealer plate unless that employee regularly works for the dealer at least 15 hours a week. Otherwise, as under prior law, an officer or an employee of the dealer can drive a motor vehicle bearing a dealer plate for any purpose and a person who is not an officer or an employee of the dealer can drive a motor vehicle bearing a dealer plate only if that person is test-driving the vehicle and has a demonstration permit.

To encourage compliance with the law concerning the use of dealer plates, the act changes the penalties for the unauthorized use of these plates and specifically prohibits a dealer from lending, renting, leasing, or otherwise placing a dealer plate at the disposal of a person who is not authorized to drive a vehicle with dealer plates. Under prior law, a dealer's license to engage in business as a motor vehicle dealer could be revoked for the misuse of dealer plates and a dealer who allowed the unauthorized use of dealer plates could arguably have been charged with a misdemeanor offense. In practice, no dealer's license was revoked for this reason and, because the law was vague, no dealer was ever charged with a misdemeanor violation for the misuse of dealer plates.

The act deletes these ineffective sanctions and substitutes three new sanctions. It declares that a violation of any of the restrictions on the use of dealer license plates is an infraction committed by the individual driving the car, is grounds for a civil penalty payable by the dealer of $200, and is grounds for the rescission by the Division of Motor Vehicles of all dealer plates issued to the dealer.

In addition to imposing new restrictions on the use of dealer plates and new penalties for their misuse, the act changes the fees for dealer plates. Under prior law, the fee for each dealer plate was $10. The act increases the fee for the first five dealer plates issued to the same dealer from $10 each to $20 each, but leaves the fee for the sixth and subsequent plates issued to the same dealer at $10 each.

Finally, the act makes administrative and technical changes to the dealer plate laws. One administrative change clarifies that all dealer plates must be turned in when a dealer's license is surrendered. Another administrative change deletes the requirement that a copy of a title or a manufacturer's certificate of origin be carried in a vehicle driven with dealer plates and substitutes a requirement that a registration card be carried.

The technical changes primarily sort motor vehicle dealer plate provisions and motor vehicle dealer licensing provisions, group the former into rewritten G.S. 20-79, and insert the latter into the appropriate statute in Article 12 of Chapter 20 of the General Statutes, the Motor Vehicle Dealers and Manufacturers Licensing Law. For example, Section 3 moves the requirement that an application for a motor vehicle dealer's license be accompanied by an application for dealer license plates from G.S. 20-79 to G.S. 20-288(a) because it is a requirement for licensure, and Sections 8 and 11 move from G.S. 20-110 to G.S. 20-294(11) and (12) in Article 12 two grounds for revocation of a dealer's license.

In sorting the provisions, the act repeals obsolete or redundant provisions. For example, in Article 12, G.S. 20-287 requires motor vehicle dealers and manufacturers to be licensed and G.S. 20-308 makes it a general misdemeanor to fail to get a dealer's license or for a person who is not a dealer to get dealer plates. The act therefore deletes provisions similar to these from G.S. 20-79. Similarly, because rewritten G.S. 20-79 makes it clear that only a dealer can

obtain dealer plates, Section 10 of the act repeals G.S. 20-293, which states the same restriction.

In addition to the technical changes that sort dealer plate and dealer licensing provisions, the act makes conforming changes to various statutes to reflect the changes in rewritten G.S. 20-79. For example, Section 9 deletes a reference in G.S. 20-111(l) to exemptions in G.S. 20-79 because G.S. 20-79 no longer contains any exemptions. Similarly, Section 12 deletes unnecessary references to the use of dealer plates from the statute governing the transfer of a vehicle to a dealer or an insurance company.

Transporter Plate Changes

The act expands the allowable uses of transporter plates, primarily to provide dealers with plates that can be used in lieu of dealer plates, and changes the fee for a transporter plate. In contrast to a dealer plate, a transporter plate can be used only for a limited purpose. It is therefore easier to detect an unauthorized use of a transporter plate than of a dealer plate.

The act adds the following four uses for transporter plates: to pick up for repair, road-test, and then deliver to the dealer a vehicle that is offered for sale by a dealer, to drive a motor vehicle to or from a motor vehicle auction, to drive a vehicle that is at least 25 years old in a parade or other public event, and to drive a motor vehicle that is part of the inventory of a dealer to a motor vehicle trade show. These new uses are contained in rewritten G.S. 20-79.2(a)(4) and new G.S. 20-79.2(a)(5), (8), and (9).

The act changes the fee for a transporter plate to bring it closer to the fee for a dealer plate. The act sets the fee for a transporter plate at $10. Under current law, the fee for a transporter plate is $19 for the first plate issued to the same person and is $6 for each additional plate issued to the same person. Like dealer plates, transporter plates are issued on a yearly basis and are not specific to a vehicle. They can therefore be switched from one vehicle to another as long as the use of each vehicle remains within the allowable uses.

In expanding the allowable uses of transporter plates, the act makes technical changes to the transporter plate provisions. It incorporates all the allowable uses of transporter plates into subsection (a) of G.S. 20-79.2 and makes conforming changes required because of this new arrangement. Section 4 deletes G.S. 20-79.2(b) but moves its content to new G.S. 20-79.2(a)(8). Similarly, Section 5 repeals the statute that currently authorizes the use of transporter plates for house trailers and mobile homes because the authorization is moved to new G.S. 20-79.2(a)(7) in Section 4. Section 6 makes a conforming change to remove a reference to repealed G.S. 20-79.3, which was incorporated into G.S. 20-79.2(a)(7).

Special Sports Event Temporary Plate

The act authorizes a new type of plate for use by motor vehicle dealers. The new plate is called a special sports event temporary plate. It can be obtained only by a dealer and used only on a vehicle that is in the dealer's inventory and is loaned by the dealer to another for use at a special sports event. A "special sports event" is a sports event that is held no more than once a year and is open to the public. The Greater Greensboro Open Golf Tournament is an example of a special sports event. The fee for a special sports event temporary plate is $5.00 for each plate.

A special sports event plate is valid for up to 45 days. When obtaining a special sports event plate, a dealer may specify a shorter period of time during which the plate is valid. When the plate expires, the dealer to whom it is issued must destroy it. The plate will be a cardboard

plate similar to the 30-day cardboard plate issuable to the buyer of a motor vehicle for use until the Division issues the regular plate for the vehicle.

Unrelated Technical Changes

Sections 1 and 11 make technical changes that are unrelated to the substantive changes discussed above. Section 1 removes the 6-month limit on how often a person can apply for a motor vehicle dealer's license and makes a technical change to eliminate an incorrect reference to an established place of business. The limitation is removed because it appears to serve no purpose. Among other changes, Section 11 eliminates an incorrect reference to an established place of business. G.S. 20-288(d) requires a wholesaler to have an established office and a motor vehicle dealer to have an established salesroom. The correct term, therefore, is either established office or established salesroom, not established place of business.

1993 Chapter 442 (Senate Bill 1025, Sen. Kerr)

AN ACT TO PROVIDE FOR PAYMENT OF THE CIGARETTE TAX BY REPORTING RATHER THAN BY TAX STAMPS.

This act changes the method of collecting the State excise tax on cigarettes from a stamp method to a reporting method and reduces the discount allowed when paying the tax from 7/24¢ per stamp to 4% of the amount of tax payable. The per stamp discount amounts to $1.75 for each case of 60 cartons of cigarettes, which is approximately 6.28%. The changes become effective January 1, 1994. The changes are expected to increase General Fund revenue by $1.1 million each fiscal year. This increase is the result of a cost savings of $200,000 from no longer having to print the tax stamps and a reduction of $900,000 in the annual amount of cigarette tax discounts allowed.

Under current law, the State cigarette excise tax is paid through the use of tax stamps that are bought from the Department of Revenue by the distributor of the cigarettes and placed on each pack of cigarettes. The stamp indicates that the State excise tax has been paid. Effective January 1, 1994, the tax will be submitted with a monthly return filed with the Department of Revenue.

With the change in collection method, North Carolina becomes the fifth state that does not require tax stamps on cigarettes. The other four states are Alaska, Hawaii, Michigan, and North Dakota. This change also make collection of the State cigarette excise tax like collection of the State excise taxes on other tobacco products, soft drinks, and alcoholic beverages. All of these other excise taxes are paid by means of a monthly report and those who file the reports are allowed a 4% discount. The current per stamp discount is allowed as compensation for the expense of handling the stamps. Similarly, the 4% discount will be allowed as compensation for the expense of preparing the records and reports associated with payment of the cigarette excise tax and for the expense of furnishing a bond to the State. Unlike the other excise tax discounts, however, the 4% cigarette excise tax discount is not intended to cover the expense of paying the tax on products that subsequently cannot be sold because they become stale or otherwise become unsuitable for sale. Distributors of cigarettes will be allowed a refund of tax paid on packages of unsalable cigarettes that are returned to the manufacturer of the cigarettes. A refund of tax paid on these cigarettes, less the discount allowed, can be obtained by filing a refund claim with the Department of Revenue.

North Carolina levies an excise tax on cigarettes at the rate of 2 1/2 mills per individual cigarette. This translates to 5¢ per pack of cigarettes. The tax does not apply to free samples

of cigarettes either given in packages of five or fewer cigarettes or given to cigarette factory workers.

Under current law, only licensed distributors may obtain unstamped cigarettes. If a person other than a distributor comes into possession of cigarettes upon which the excise tax has not been paid, that person must pay a use tax at the same rate as the excise tax. Similarly, under the act, only licensed distributors may obtain non-tax-paid cigarettes and anyone else who comes into possession of non-tax-paid cigarettes is liable for the use tax on the cigarettes.

Under current law, it is unlawful to transport, sell, or offer to sell unstamped cigarettes, except that tourists and others traveling to this State may possess up to 600 unstamped cigarettes (three cartons) for personal use. Possession of more than 600 unstamped cigarettes by anyone other than a licensed distributor is prima facie evidence that the cigarettes are possessed in violation of the tax law. Unstamped cigarettes, their container, and any vehicle or vessel in which they may be transported are contraband goods subject to seizure and confiscation.

Effective January 1, 1994, it will still be unlawful to transport, sell, or offer to sell non-tax-paid cigarettes, and non-tax-paid cigarettes, their container, and any vehicle or vessel in which they were transported will still be contraband goods. Unless the cigarettes bear the stamp of another state or country, however, law enforcement officers will not know by looking at them whether the North Carolina tax has been paid and, consequently, whether or not they are non-tax-paid cigarettes.

1993 Chapter 443 (Senate Bill 1141, Sen. Kerr)

AN ACT TO EXPAND THE TAX CREDITS FOR QUALIFIED BUSINESS INVESTMENTS AND TO PROVIDE THAT THE TAX CREDITS SHALL SUNSET FOR INVESTMENTS MADE ON OR AFTER JANUARY 1, 1999.

I. INTRODUCTION

Chapter 443 of the 1993 Session Laws makes a number of changes to the Qualified Business Investments Tax Credits, effective beginning with the 1994 tax year. Some of the changes, such as allowing partnerships to qualify for the credits and allowing investors to participate in the businesses, are designed to expand the credit. Other changes, such as reducing the maximum annual investment for individuals and prohibiting certain types of businesses from qualifying for the credit, narrow the credit. Other changes are designed to clarify the law and make it easier to administer. It is not known what effect these changes will have on General Fund revenues. The law as in effect until 1994 is summarized below as "former law." The changes made by the act are outlined following the summary of former law.

II. FORMER LAW

Division V of Article 4 of Chapter 105 of the General Statutes, Tax Credits for Qualified Business Investments, was enacted in 1987 to allow tax credits to individuals and corporations that invest in qualified North Carolina businesses or the North Carolina Enterprise Corporation. For individuals, the credit is allowed against individual income taxes. For corporations, the credit is allowed against corporate income taxes, franchise taxes, and insurance premiums taxes.

Until the 1994 effective date of Chapter 443, the amount of the credit allowed is 25% of the amount invested, up to a maximum credit of $100,000 for individuals and $750,000 for corporations. If the allowable credit exceeds the taxpayer's tax liability, the excess may be

carried forward for up to five years. The total amount of tax credits that can be granted to individuals or corporations in any tax year is capped at $12 million. The investors apply for the credit through an application filed with the Department of Revenue by April 15; the Department then determines whether the $12 million cap has been exceeded and, if so, proportionally reduces the amount of each credit applied for.

Until the 1994 tax year, individuals are allowed credits for investments in the equity securities or subordinated debt of the North Carolina Enterprise Corporation and of three types of qualified businesses: qualified business ventures, qualified grantee businesses, and qualified investment organizations. Corporations are allowed credits only for investments in the equity securities of the North Carolina Enterprise Corporation and of one type of qualified business: qualified investment organizations.

A qualified business venture is a company that is headquartered and has most of its operations in North Carolina, had less than $5 million in sales in the prior year, and engages primarily in manufacturing, processing, warehousing, wholesaling, research and development, or a service-related industry. A qualified business venture may not engage primarily in construction, contracting, retailing, or investing.

A qualified grantee business is a company that is headquartered and has most of its operations in North Carolina and has received funding during the past three years from the North Carolina Biotechnology Center, the North Carolina Microelectronics Center, the Technological Development Authority, or the federal Small Business Innovation Research program.

A qualified investment organization is a firm engaged primarily in the business of investing in qualified business ventures and qualified grantee businesses. Since the enactment of the qualified business investment tax credits, no tax credits have been claimed for investments made in qualified investment organizations.

The North Carolina Enterprise Corporation is an entity formed under Article 3 of Chapter 53A of the General Statutes to make investments in small North Carolina businesses. The Corporation focuses on investments that have significant potential to create jobs and diversify and stabilize the economy of rural areas of the State.

Qualified businesses must register with the Secretary of State and renew their registrations annually. There is a $100.00 fee for registration and a $50.00 fee for renewal. Since 1988, the Secretary of State has registered 121 qualified business ventures and qualified grantee businesses but no qualified investment organizations. Individuals and corporations have applied for approximately $14 million in tax credits, which represents $56 million in investment in small North Carolina companies.

Under the law in effect until 1994, an investor in a qualified business venture or a qualified grantee business forfeits the tax credit if one of the following occurs within three years after the investment was made:

(1) The investor or the investor's family participates in the operation of the business.

(2) The business fails to renew its registration, other than solely because its revenues have grown above $5 million per year.

(3) The business has its registration revoked by the Secretary of State.

III. CHANGES MADE BY CHAPTER 443

Only Direct Investments Qualify

The act provides that the tax credit applies only to investments made in securities purchased directly from the qualified business. Under former law, a credit would potentially be available to both the original purchaser of the securities from the business and a person to whom the original purchaser sold the securities.

Pass-through Entities May Take Credit

The act provides that a pass-through entity may qualify for the credit and pass it on to the entity's owners. Under former law, only corporations and individuals could qualify for the credit. A pass-through entity is an entity, such as a partnership or a Subchapter S corporation, that is treated as owned by individuals or other entities under federal tax law and whose income, losses, and credits are reported by the owners on their State income tax returns. The pass-through entity may qualify for up to $750,000 of the credit per year. Investments in the equity securities or subordinated debt of any type of qualified business may be passed through to individuals; only investments in the equity securities of the North Carolina Enterprise Corporation may be passed through to corporations. This treatment parallels the types of investments for which credits are available to individuals and corporations.

Limit on Individuals' Credits Reduced

The act reduces from $100,000 to $50,000 the amount of credit an individual may claim each tax year for investments in qualified businesses.

Types of Qualified Business Ventures Restricted

The act provides that a business formed for the primary purpose of acquiring one or more other businesses does not qualify for the tax credit. In response to concerns that the credit was being used for inappropriate businesses such as law firms and golf courses, the act also provides that the credit does not apply to firms engaged primarily in the following types of businesses:

(1) A real estate-related business. A real estate-related business is a business involved in or related to the brokerage, selling, purchasing, leasing, operating, or managing of hotels, motels, nursing homes or other lodging facilities, sports or social clubs, restaurants, storage facilities, or commercial or residential lots or buildings.

(2) Providing a professional service. This category includes accountants, architects, attorneys, medical professionals, psychologists, occupational therapists, geologists, and foresters.

(3) Providing personal grooming or cosmetics services.

(4) Offering any form of entertainment, amusement, recreation, or athletic or fitness activity for which an admission or membership is charged.

Rules for Investor Participation in Business Modified

Under former law, an investor would forfeit the tax credit if the investor or the investor's family participates in the business. This act will allow investors and their families to participate actively in the business as long as they receive no financial compensation for their services aside from reimbursement for expenses and/or participation in a stock option or stock bonus plan. The act also adds siblings to the types of family members who may not participate in the business for compensation.

Monitoring of Businesses Required

This act requires an application for renewal of registration as a qualified business to indicate whether the business is a minority business and to report the number of jobs created in the previous year that are attributable to the tax credit as well as the average wages paid by each job. In addition, it requires the Secretary of State to report to the Legislative Research Commission annually the following information about each qualified business registered for the investment tax credit: name and address, types of business in which it engages, whether it is a minority- or women-owned business, the number of jobs created by the business, and the average wages paid by these jobs.

Five-Year Sunset Placed on Tax Credit

Section 7 of this act repeals the entire tax credit for qualified business tax credits effective for investments made on or after January 1, 1999. This repeal will not affect carryforwards and credits for investments made before January 1, 1999.

Forfeiture Required for Transfer or Redemption of Securities

This act provides that an investor forfeits the tax credit for an investment in the North Carolina Enterprise Corporation or in a qualified business in the following cases:

(1) Within one year after making the investment, the investor transfers the securities, other than as a result of an individual investor's death, a corporate investor's liquidation, or a corporate investor's merger or consolidation approved by the North Carolina Enterprise Corporation or the qualified business.

(2) Within five years after the investment, the North Carolina Enterprise Corporation or the qualified business redeems the securities.

Limitations Period Extended for Assessments Based on Forfeitures

The statute of limitations for assessing taxes is, in most cases, three years after the tax return was filed or was required to be filed, whichever is later. Because forfeitures of qualified business investment tax credits may occur years after the credit was allowed, Section 6 of this act provides that the Department of Revenue may assess the tax due as a result of a forfeiture within three years after the date of the forfeiture.

No Forfeiture Required for Failure to Renew Registration

The act provides that an investor does not forfeit the tax credit if the qualified business fails to renew its registration with the Secretary of State, unless the business was unable to renew its registration because it has moved out of North Carolina or failed to relocate into North Carolina. If a qualified business venture fails to renew its registration, its registration is revoked, but it may apply to have its registration reinstated upon payment of a late filing penalty of $1,000. Under former law, an investor in a qualified business venture forfeited the credit for the investment if, within three years, the business failed to renew its registration, unless the failure to renew was solely because the business' revenues had grown beyond $5 million per year.

Restrictions on Registration Effective Date and Transfer Clarified

The act provides that the effective date of a qualified business's registration is the date the application is filed, rather than the date the application is approved. This provision allows investors a credit for investments made in a qualified business while waiting for its application to be approved. If the application is not approved, however, the investments will not qualify for the credit. The act also provides that registration as a qualified business may not be transferred from one business to another; however, if a qualified business is involved in a merger

or consolidation and the surviving company qualifies for the registration, the surviving company may retain the registration.

Other Changes

This act makes the following additional changes:

(1) Repeals the provisions of the former law allowing tax credits for investments in qualified investment organizations. Because no tax credits have ever been claimed for these investments, it appears that this part of the law is serving no purpose.

(2) Clarifies the definition of "selling or leasing at retail."

(3) Allows the Department of Revenue to extend until September 15 the April 15 deadline for applying for the tax credit.

(4) Clarifies that the $50,000 and $750,000 annual limits on tax credits for individuals and corporations, respectively, do not apply to amounts carried forward from a previous tax year.

(5) Provides that the investor's basis in the securities representing the investment for which a credit is allowable will be reduced by the amount of the allowable credit, and adds a conforming change to the individual income tax law to allow taxation of the resulting gain when the securities are disposed of.

(6) Provides that if an investment is paid for other than in money, the taxpayer must include with the application for the credit a certified appraisal of the property used to pay for the investment.

(7) Clarifies that the Secretary of State will not revoke the registration of a qualified business solely because the business has ceased business operations.

(8) Provides that a person who submits a false application for registration as a qualified business is guilty of a general misdemeanor.

1993 Chapter 450 (House Bill 174, Rep. Luebke)

AN ACT TO AUTHORIZE THE DEPARTMENT OF REVENUE TO ALLOW OR REQUIRE PAYMENT OF TAXES BY ELECTRONIC FUNDS TRANSFER.

This act authorizes the Department of Revenue to require a taxpayer who owes an average of $20,000 a month of a type of tax to pay that tax by electronic funds transfer. An electronic funds transfer is a transfer of funds that is initiated through an electronic terminal, a telephone, or a computer to authorize a financial institution to debit or credit a taxpayer's account. The processing of certain tax payments electronically will enable the State Treasurer to invest tax receipts sooner due to the reduced float time in receiving mail through the postal service and clearing checks through the banking system. The Department of Revenue estimates that the increased earnings on this decreased float will be approximately $1 million in fiscal year 1993-94 and $2 million in fiscal year 1994-95. The General Assembly appropriated $400,000 in fiscal year 1993-94 and $310,000 in fiscal year 1994-95 to the Department of Revenue in the expansion budget to enable the Department to implement an electronic funds transfer program.

The act became effective August 1, 1993. However, because of the time needed by the Department of Revenue to implement the program, the earliest date that electronic payments

could actually be required is January 1, 1994. The act prohibited the Department from requiring the payment of motor fuels taxes or inspection fees by electronic funds transfer earlier than July 1, 1995. The Department of Revenue plans to phase the electronic funds transfer program in over several years. As planned, the program will be limited to the largest taxpayers and to taxes that are paid quarterly or more frequently. The first phase of the program, planned to begin January 1, 1994, involves withholding tax and corporate income tax. Later in 1994, utilities sales tax, utilities franchise tax, alcoholic beverages excise tax, and sales and use tax will be added. Initially, taxpayers with average payments of a single tax of $100,000 a month will be required to pay electronically. This threshold will be lowered as the program is developed, with full implementation for all targeted business taxes expected by the end of 1996.

The act enables the Department of Revenue to implement tax payments by electronic funds transfer by eliminating provisions in the former law that prohibit these payments. Some of these provisions require a tax to be paid at an office of the Department of Revenue and some require a tax to be paid by cash or check. This act deletes these conflicting provisions and substitutes a requirement that a tax be paid at the place and in the form required by the Secretary.

The monthly threshold applies separately to each tax. The Secretary will notify taxpayers who must pay taxes electronically and will educate them about the procedures to be followed. After the Secretary requires a taxpayer to pay a tax by electronic funds transfer, the Secretary must review the taxpayer's average payments at least annually. If the average amount of the payments falls below the $20,000 threshold, the Secretary must suspend the electronic funds payment requirement and so notify the taxpayer.

The act adds two new tax penalties related to electronic funds transfers. The first is a penalty for making an electronic funds transfer that is not honored due to insufficient funds or nonexistence of an account. Like the penalty for a bad check, this penalty is equal to 10% of the amount of the payment, with a maximum of $1,000. Like all other penalties except the bad check penalty, this penalty may be compromised or forgiven by the Secretary of Revenue for good cause. The second is a penalty for paying a tax in a form other than the form required by the Secretary. The penalty is equal to 5% of the amount of the tax, with a maximum of $1,000. This penalty will provide an incentive for taxpayers to comply with the electronic funds transfer requirements imposed by the Secretary.

Recommended by the Revenue Laws Study Committee.

1993 Chapter 459 (Senate Bill 658, Sen. Kaplan)

AN ACT TO EXPAND THE PROPERTY TAX EXEMPTION FOR COMPUTER SOFTWARE.

This act is the result of a compromise between the North Carolina Association of County Commissioners and a taxpayer group called the North Carolina Software Coalition. It replaces the current property tax exemption for certain computer software used by manufacturers, wholesalers, and retailers with an across-the-board property tax exemption for all computer software, and its related documentation, other than embedded software and software that the taxpayer buys or licenses from an unrelated seller and that is required by generally accepted accounting principles to be treated as a capital asset. The new exemption is effective for property taxes imposed for taxable years beginning on or after July 1, 1994.

The original purpose of the Software Coalition was to expand the current property tax exemption for certain computer software to include all computer software. As introduced, therefore, this legislation exempted all computer software from property taxes. The North Carolina Association of County Commissioners pointed out that a blanket exemption for computer software would seriously erode the local property tax base and, as a result, would reduce local property tax revenues by over $10 million each year. To reduce the Association's opposition to the proposal, the Coalition agreed to the compromise reflected in this act.

The act first "undoes" the 1992 computer software exemption. That exemption, which was enacted at the request of some of the members of the Software Coalition, distorted the definition of inventories and thereby exempted certain computer software from property tax as part of the exemption for inventories. The 1992 exemption applied only to the following three kinds of software that were held by a manufacturer, a wholesaler, or a retailer and were not treated as a capital asset:

(1) Software developed or modified by the taxpayer for the taxpayer's own use.

(2) Software developed or modified by someone other than the taxpayer to the special order of or to meet the particular needs of the taxpayer.

(3) Software developed, acquired, or used to develop or enhance programs the taxpayer intended to sell to others.

The 1992 exemption was effective for two years only. It became effective for the 1992-93 tax year and is repealed by this act effective with the 1994-95 tax year. Thus, it applied only in 1992-93 and 1993-94.

After "undoing" the 1992 computer software exemption, the act establishes a new exemption for computer software effective for the 1994-95 tax year. It provides that software is exempt unless it is either embedded software or is treated as a capital asset. Thus, the new exemption applies uniformly to all taxpayers, abandons the requirement that the software be specially made to suit the taxpayer or be used by the taxpayer to develop other software, and preserves the requirement that to be exempt the software must not be considered a capital asset.

Software is another name for a computer program or computer instructions. Embedded software is software that is stored on a microchip or circuit board, is an integral part of a piece of equipment such as a dishwasher, a cash register, or an automobile, and is the reason the equipment can perform the functions it can. A seller is unrelated to a taxpayer if the seller and the taxpayer are not subject to any common ownership, either directly or indirectly, and neither the seller nor the taxpayer has a direct or an indirect ownership interest in the other.

By exempting certain computer software from the property tax, this act reduces the local property tax base. The resulting annual revenue loss to local governments is unknown.

1993 Chapter 467 (Senate Bill 128, Sen. D. Winner)

AN ACT TO EXEMPT CERTAIN TRANSFERS OF VEHICLES FROM THE HIGHWAY USE TAX, TO REIMBURSE THE HIGHWAY TRUST FUND FOR REVENUE THAT WOULD OTHERWISE BE LOST AS A RESULT OF THE EXEMPTIONS, TO INCREASE REVENUES TO PROVIDE FUNDS TO MAKE THE REIMBURSEMENT, TO LOWER THE MAXIMUM HIGHWAY USE TAX ON CERTAIN COMMERCIAL VEHICLES, TO INCREASE THE ANNUAL REGISTRATION FEES FOR

CERTAIN PROPERTY-HAULING VEHICLES, AND TO CREDIT THE INCREASED REVENUE FROM THE REGISTRATION FEES TO THE HIGHWAY TRUST FUND.

During the legislative process, this act grew from a one-section proposal concerning highway use tax exemptions to its current conglomeration of highway use tax changes and off-setting revenue increases. It changes the highway use tax by exempting three kinds of transfers from the tax, by modifying the exemption for transfers between certain family members, by reducing from $1,500 to $1,000 the maximum highway use tax payable on the transfer of a Class A or Class B commercial motor vehicle, and by allowing those who paid more than $1,000 on the transfer of one of these commercial motor vehicles to obtain a refund of the excess amount paid. Sections 1, 3, and 6 of the act make these changes; they became effective August 1, 1993.

The other changes the act makes are designed to provide revenue to off-set the revenue lost to the Highway Trust Fund as a result of the changes made to the highway use tax. The act authorizes the Division of Motor Vehicles of the Department of Transportation to use registration stickers to renew the registration of vehicles registered under the International Registration Plan, increases by 5¢ per hundred pounds the annual registration fee paid by certain property-hauling vehicles, and transfers revenue that is raised by the act in the Highway Fund to the Highway Trust Fund. Sections 2, 4, and 5 of the act make these "off-setting" changes. The authorization concerning the use of registration renewal stickers became effective August 1, 1993. The remaining off-setting changes become effective October 1, 1993.

In addition to these substantive changes the act makes numerous technical changes to the affected statutes. For example, it deletes several obsolete and inaccurate provisions in G.S. 20-66 concerning the annual renewal of motor vehicle registrations, and it changes the property-hauling vehicle registration weight categories, set out in G.S. 20-88(b), to conform to those that are used by the Division of Motor Vehicles.

Highway Use Tax Changes

The highway use tax is the tax that was enacted in 1989 to replace the sales tax on motor vehicles and provide a source of revenue for the Highway Trust Fund. The tax is 3% of the retail value of a motor vehicle, subject to a minimum tax of $40.00 and a maximum tax of either $1,000 or $1,500. Before July 1, 1993, the maximum tax for all vehicles was $1,000. Unlike the former sales tax on motor vehicles, which was payable only when a motor vehicle was sold, the highway use tax is payable every time a certificate of title is issued for a motor vehicle. A title is issued every time a motor vehicle is transferred to a new owner or the owner changes names, regardless of whether any cash changes hands in the transfer or how many times the vehicle has previously been transferred.

The three transfers the act exempts are gifts between stepparents and stepchildren, transfers of handicapped vans from the Department of Human Resources to the handicapped, and transfers to local boards of education of driver education vehicles that are either "on loan" from a dealer or are owned by another local board of education. Before August 1, 1993, the effective date of these exemptions, these three types of transfers were subject to highway use tax at the full 3%, $1,500 maximum rate.

The exemption for vehicles transferred as the result of a gift between stepparents and stepchildren is a logical extension of the current exemption for transfers between parents and children and a clarification of that exemption. When the General Assembly exempted transfers between parents and children in 1991, it assumed that stepparents and stepchildren were included in the exemption. After the exemption became effective, however, the Attorney

General's Office issued an opinion stating that the exemption for parents and children did not include stepparents and stepchildren. This act corrects this problem by specifically including transfers between stepparents and stepchildren in the list of exemptions.

The other two transfers the act exempts apply only in limited circumstances. One applies to vehicles that are transferred to a handicapped person from the Department of Human Resources after the Department has equipped the vehicle for use by the handicapped. The other applies to certain driver education vehicles.

The purpose of the exemption for vehicles transferred to the handicapped by the Department of Human Resources is to prevent two payments of highway use tax on the same vehicle within a short period of time. The Department of Human Resources pays highway use tax when it acquires a vehicle to be equipped for use by the handicapped. Before this exemption became effective, the handicapped person to whom the Department of Human Resources transferred the vehicle also paid highway use tax on the vehicle upon the transfer. This exemption eliminates the second payment of highway use tax in this circumstance by exempting the transfer to the handicapped person from the tax.

The purpose of the driver education exemption is to avoid increasing the cost of the driver education program in the public schools. This goal is accomplished by exempting from the tax the transfer of driver education vehicles that either are "on loan" from a motor vehicle dealer or were transferred between local boards of education. A vehicle is considered to be "on loan" from a dealer when it is transferred by the dealer to a local board of education and the dealer and the local board agree that the local board will transfer the vehicle back to the dealer within 300 days.

The act further changes the highway use tax exemptions by limiting the exemption for transfers between husbands and wives or parents and children to transfers that are the result of gifts. This same limitation applies to the new exemption for transfers between stepparents and stepchildren. Under prior law, all sales and other transfers of motor vehicles between spouses or between parents and children were exempt from the tax.

In addition to changing the highway use tax exemptions, the act lowers from $1,500 to $1,000 the maximum highway use tax payable on the transfer of a Class A or Class B commercial motor vehicle and allows a person who paid more than this new maximum on one of these vehicles to obtain a refund of the excess amount paid. It does not change the maximum tax on a non-commercial motor vehicle.

A Class A or Class B commercial motor vehicle is a vehicle that weighs at least 26,001 pounds, either alone or in combination with a towed unit that weighs at least 10,001 pounds. In general, these vehicles are truck tractors and large trucks and, to drive them, a person must have the appropriate class of commercial drivers license. The fact that a vehicle is used commercially or has a registration plate bearing the word "commercial" does not determine whether the vehicle is a Class A or Class B commercial motor vehicle. Many vehicles that are used in a business and that have commercial plates are not Class A or Class B commercial motor vehicles because they do not meet the statutory definition of those vehicles.

For the period July 1, 1993, until August 1, 1993, the maximum tax on Class A and Class B commercial motor vehicles was $1,500 instead of $1,000. This is because the maximum tax increased from $1,000 to $1,500 effective July 1, 1993, and the reduction made by this act did not become effective until August 1, 1993. This act therefore allows a person to whom a Class A or Class B commercial motor vehicle was transferred during the month of July and who paid more than $1,000 tax on the transfer to obtain a refund for the amount that exceeds

$1,000. To obtain a refund, the person must submit a claim to the Division of Motor Vehicles by January 1, 1994.

The changes in the highway use tax exemptions are expected to result in an annual loss of revenue to the Highway Trust Fund of $300,000. The reduction in the maximum highway use tax payable on the transfer of a Class A or Class B commercial motor vehicle is expected to result in an annual loss of revenue to the Highway Trust Fund of $2.2 million. The act transfers to the Highway Trust Fund revenue generated in the Highway Fund by the offsetting changes described below. The result is that the neither the Highway Trust Fund nor the Highway Fund loses money as the result of the changes.

Offsetting Revenue Changes

The act increases revenue in the Highway Fund by increasing certain annual vehicle registration fees and by authorizing the Division of Motor Vehicles to renew by means of a renewal sticker the registration of a vehicle that is registered under the International Registration Plan. Raising the annual registration fee generates most of the $2.5 million annual increase in Highway Fund revenue expected to occur as a result of the changes. The change in the renewal method results in a reduction in costs rather than an increase in a stream of revenue.

The act increases by 5¢ per hundred pounds the annual vehicle registration fee payable by property-hauling vehicles that are registered for 5,000 pounds or more and are in the private hauler, contract carrier, flat rate common carrier, and exempt for-hire carrier category. It therefore does not increase the annual registration fee for the average pick-up truck because most pick-up trucks are registered at 4,000 pounds, nor does it increase the annual vehicle registration fee for vehicles in the farmer category.

The act increases the annual registration fee on certain property-hauling vehicles rather than raise other fees because some of the property-hauling vehicles whose annual registration fee is increased are in the group of commercial motor vehicles that will benefit from the reduction in the maximum highway use tax. To some extent, therefore, the same people who benefit from the tax reduction will provide revenue through the increased fees to cover the loss. The group whose fees are increased, however, is much larger than the group that will enjoy the reduction in the maximum highway use tax because the fee increases start at 5,000 pounds rather than 26,000 pounds.

The new property-hauling registration fee structure also abandons the historical relationship between the rate for the farmer category and the other category. Traditionally, the farmer rate has been one-half the regular rate. With the increase made by this act, the farm rate will be less than one-half the regular rate for every weight category except 4,000 pounds.

The other way the act increases revenue in the Highway Fund is by authorizing the Division of Motor Vehicles to renew the registration of vehicles registered under the International Registration Plan by means of a sticker. That Division currently renews the registration of these vehicles by issuing a new plate each year. The new plates are all issued on a calendar year basis.

Before this act changed the law on this subject, the Division could not renew these plates by means of a sticker. Switching to renewal by sticker will allow the Division to stagger the renewals and to avoid the cost of the new plates. This change was recommended by an audit of the Division of Motor Vehicles performed by the State Auditor.

After it increases revenue in the Highway Fund, the act transfers revenue from the Highway Fund to the Highway Trust Fund. The transfer compensates the Highway Trust Fund for revenue that is lost to it by the highway use tax changes the act makes. The transfer is made by putting into the Highway Trust Fund part of the title fee that currently goes to the Highway Fund. Effective October 1, 1993, the Highway Trust Fund will receive $31.50 of every $35 title fee instead of $30 of every $35 title fee.

Section 1 of this act was recommended by the Revenue Laws Study Committee.

1993 Chapter 471 (Senate Bill 60, Sen. Odom)

AN ACT TO IMPOSE AN ADVANCE DISPOSAL TAX ON NEW WHITE GOODS, TO REQUIRE EACH COUNTY TO PROVIDE FOR THE MANAGEMENT OF DISCARDED WHITE GOODS, AND TO PROVIDE FOR THE REMOVAL OF CHLOROFLUOROCARBON REFRIGERANTS FROM WHITE GOODS.

This act imposes a temporary tax on white goods and provides for the removal of chlorofluorocarbon refrigerants from discarded white goods. The tax becomes effective January 1, 1994, and expires July 1, 1998. A white good is a domestic or commercial large appliance, such as a refrigerator, a water heater, an air conditioner unit, or a dishwasher. Chlorofluorocarbon refrigerant is a type of gas that must be removed from a white good under federal law. Chlorofluorocarbon refrigerants are currently being phased out and will be banned as of January 1, 1996, by the Environmental Protection Agency (EPA). The EPA contends that chlorofluorocarbon refrigerants, if improperly removed, may pose a serious threat to the environment. The cost to properly remove the gas is between $5 and $17 per white good.

The act imposes a flat rate tax on each new white good sold in this State of $5 if the new white good does not contain chlorofluorocarbon refrigerants and $10 if the new white good does contain chlorofluorocarbon refrigerants. The tax is collected and administered, to the extent practical, as if it were an additional State sales tax. A person who buys 50 new white goods of any kind may obtain a refund of 60% of the amount of tax imposed when all of the white goods purchased are to be placed in new or remodeled dwelling units that are located in the State and do not already contain the kind of white good purchased. Neither a local government unit nor a contracting party can charge a person an additional fee for the disposal of white goods until July 1, 1998, which is the date the white goods disposal tax expires.

The tax is expected to generate a little over $2 million in fiscal year 1993-94 and approximately $4.5 million annually in fiscal years 1994-95 through 1997-98. For the first year of the tax, the Department of Revenue may deduct its cost of collection, not to exceed $225,000, from the proceeds of the tax. Each quarter the Secretary shall distribute the proceeds of the tax as follows:

(1) 5% to the Solid Waste Management Trust Fund. The money in this Fund is used to fund activities of the Department of Environment, Health, and Natural Resources (DEHNR) to promote waste reduction and recycling, to fund research on the solid waste stream in North Carolina, to fund activities related to the development of secondary materials markets, to fund demonstration projects, and to fund research by in-State colleges and universities.

(2) 20% to the White Goods Management Account. The money in this Account will be used to make grants to local governmental units to assist them in managing discarded white goods.

(3) 75% to the 100 counties on a per capita basis to be used only for the management of discarded white goods.

Each county must provide at least one site for the collection of discarded white goods. The act also requires each county to provide for the disposal of discarded white goods and for the removal of chlorofluorocarbon refrigerants from white goods. A county may contract with another unit of local government or with a private entity for the management of discarded white goods or for the removal of chlorofluorocarbon refrigerants from white goods. A county must establish written procedures for the management of white goods and must include these procedures in any solid waste management plan required by DEHNR.

If a county's costs of managing white goods for a six-month period exceeds the amount the unit receives from the per capita distribution of the white goods disposal tax, the county is eligible to apply for a grant from the White Goods Management Account. A grant to a unit may not exceed the unit's unreimbursed cost of managing white goods for the six-month period. The grant program will be administered by the DEHNR and will remain in effect until July 1, 1999.

Under the act, DEHNR may assess a civil penalty of not more than $100 against a person who, knowing it is unlawful, disposes of a discarded white good in a landfill, an incinerator, or a waste-to-energy facility. The Department may also assess a civil penalty of up to $100 against a person who, knowing it is required, fails to remove chlorofluorocarbon refrigerants from a discarded white good. These penalties may be assessed for each day the violation occurs. The civil penalties collected will be credited to the General Fund as nontax revenue.

1993 Chapter 484 (Senate Bill 154, Sen. Seymour)

AN ACT TO MAKE MOBILE CLASSROOMS AND MOBILE OFFICES SUBJECT TO SALES TAX RATHER THAN HIGHWAY USE TAX AND TO EXEMPT CERTAIN MOBILE CLASSROOMS FROM SALES TAX.

This act makes two changes in the law concerning the taxation of mobile offices and mobile classrooms. First, it makes mobile offices and mobile classrooms subject to sales tax rather than highway use tax. Second, it exempts from sales tax mobile classrooms sold to a local board of education or a local board of trustees of a community college. The changes become effective October 1, 1993. The changes are expected to increase General Fund sales and use tax revenue by $150,000 each year and to reduce highway use tax revenue by $30,000 each year. The net fiscal effect therefore is a gain of $120,000 each year.

The act makes the first change to avoid the potential revenue loss that occurs when mobile offices and mobile classrooms are not titled. Mobile offices and mobile classrooms are currently subject to highway use tax rather than sales tax because they are considered to be motor vehicles. Motor vehicles are subject to highway use tax and are not subject to sales tax. The highway use tax is collected only when a vehicle is titled. Although the law requires mobile classrooms and mobile offices to be titled, many are not. Consequently, no highway use tax is being collected on many mobile classrooms and mobile offices.

The act makes the second change to avoid imposing an additional tax burden on local boards of education and local boards of trustees of community colleges. Without the exemption, the act would impose an additional tax burden on these local boards when they purchase mobile classrooms because even though they are required to title mobile classrooms, they frequently do not and therefore frequently do not pay the highway use tax due on the mobile classrooms.

The act does not change the rate of tax that applies to mobile offices and mobile classrooms. Its practical effect, therefore, is to collect the same amount of tax when a mobile office or a non-exempt mobile classroom is sold instead of when it is titled.

Section 1 of the act removes mobile offices and mobile classrooms from the definition of "motor vehicle" that is used for sales tax purposes so that they will be subject to sales tax rather than highway use tax. Section 2 sets the sales tax rate that will apply to mobile offices and mobile classrooms; the rate set is the same as the current highway use tax rate. The highway use tax rate for mobile offices and mobile classrooms is 3% of the retail value of the vehicle, subject to a maximum tax of $1,500. As with manufactured homes, each segment of a double-wide mobile office or mobile classroom will be considered a separate item and the maximum tax will apply to each of the segments. Section 3 contains the exemption for mobile classrooms sold to local boards of education or local boards of trustees of community colleges.

Before the enactment of the highway use tax in 1989, manufactured homes, mobile offices, and mobile classrooms were all subject to sales tax at the rate of 2% with a $300 cap on each segment. The highway use tax legislation distinguished between manufactured homes, mobile offices, and mobile classrooms, leaving the first of these three subject to sales tax and making the last two of these subject to highway use tax. This act once again makes all three of these items subject to sales tax.

Recommended by the Revenue Laws Study Committee.

1993 Chapter 485 (Senate Bill 155, Sen. Plexico)

AN ACT TO MAKE TECHNICAL AND CONFORMING CHANGES TO THE REVENUE LAWS AND TO CLARIFY AND MODIFY THE TAX SECRECY PROVISION.

Sections 1 through 30 of this act makes numerous technical and clarifying changes to the revenue laws and related statutes. The remaining sections of this act clarify, reorganize, and modify the statutes governing secrecy of government tax records. These sections were introduced by Representative Gamble in House Bill 74. The act became effective upon ratification, July 23, 1993.

TECHNICAL CHANGES

The following table provides an analysis of the technical changes made by the first 30 sections of the act:

Section	Explanation
1	Repeals a Session Law that is ineffective because the language it amended had already been deleted by an earlier Session Law.
2	Makes a conforming change to reflect the fact that official population estimates that were formerly certified by the State Budget Officer are now certified by the State Planning Officer.

3 Removes stray language from a statute; the language resulted because the changes made to a statute by two different acts enacted in 1993 were in conflicting forms. This is not a substantive change (see the summaries for Chapters 362 and 371, above).

4 Removes inaccurate provisions regarding the scope of G.S. 105-122 contained in the franchise tax exemptions statute and reorganizes and clarifies the language of the statute. The removed provisions are corrected and placed in the appropriate statute in Section 5.

5 Corrects inaccurate provisions regarding the scope of G.S. 105-122 and places the provisions in the appropriate introductory statute applicable to franchise taxes.

6 G.S. 55-14-05(c) of the Business Corporation Act provides that a corporation that dissolves does not owe franchise tax unless it engages in business activities during the tax year. This section adds the same provision to the franchise tax law. The Department of Revenue is currently administering the law in accordance with this provision. This change was requested by the Department of Revenue.

7 Makes a conforming change to reflect the fact that official population estimates that were formerly certified by the State Budget Officer are now certified by the State Planning Officer.

8 Makes a conforming change to a cross-reference to G.S. 105-134.6, which is rewritten by Section 9 of this act.

9 The federal courts have held that North Carolina cannot tax income earned by a member of a federally recognized Indian tribe from activities on the reservation. This section adds to the individual income tax statutes a provision explicitly recognizing that rule of law. This change was requested by the Department of Revenue.

This section also makes technical changes in the wording of the individual income tax adjustments and in the location in the statutes of some of these adjustments, as follows: it changes the word "gross" to "taxable" in a few places because some items that are to be added to or subtracted from federal taxable income are not specifically identifiable under the Code as deductions subtracted from gross income. It also creates a new subsection (d) in G.S. 105-134.6 to provide for deduction of amounts that are not specifically identified as income items included in gross income under the Code.

10 Clarifies ambiguous language in accordance with the correct interpretation by the Department of Revenue.

11 Makes a conforming change to reflect the fact that official population estimates that were formerly certified by the State Budget Officer are now certified by the State Planning Officer.

12 Substitutes the correct term "minority business" for "minority business enterprise" in the statutes requiring a business to provide background information when renewing its registration as a qualified business. Tax credits are allowed for investments in certain businesses that have registered as qualified businesses. For more information, see the summary of Chapter 443, above.

13 Makes a conforming change to reflect the fact that official population estimates that were formerly certified by the State Budget Officer are now certified by the State Planning Officer.

14 Corrects an incorrect cross-reference and simplifies some awkward statutory language. This change was requested by the Department of Revenue.

15 Removes redundant language regarding the scope of Article 9 of Chapter 105 of the General Statutes. The scope of Article 9 is set out in G.S. 105-228.90.

16 Makes a conforming change to reflect the fact that official population estimates that were formerly certified by the State Budget Officer are now certified by the State Planning Officer.

17 Deletes a reference to a repealed subsection.

18 Excludes short term rental vehicles from the new system for collecting property taxes on motor vehicles. The old system of taxation, in which the vehicles will be listed by the company, is more appropriate for these vehicles. This change was requested by the Department of Revenue and the Association of County Commissioners.

19 Removes incorrect and unnecessary cross-references.

20 - 21 Clarify that the penalty for failure to file an additional bond for motor fuel tax purposes also applies to failure to file a replacement bond. This change was requested by the Department of Revenue.

22 Removes a reference to a provision, repealed in Section 23, allowing counties to collect their own local sales and use taxes.

23 Repeals a provision allowing counties to collect their own local sales and use taxes.

24 Makes a conforming change to reflect the fact that official population estimates that were formerly certified by the State Budget Officer are now certified by the State Planning Officer. Simplifies and clarifies awkward statutory language.

25 - 27 Remove references to a provision, repealed in Section 23, allowing counties to collect their own local sales and use taxes.

28 Deletes a reference to a repealed statute and substitutes the applicable provisions of that statute.

29 Conforms the catchline of G.S. 105-449.15 to reflect its true content. The exemption from the special fuels tax for nonanhydrous ethanol expired on January 1, 1993.

30 Repeals the exemption for nonanhydrous ethanol from the gasoline tax statute so that it conforms with the special fuels tax statute. The exemption in the special fuels tax statute expired on January 1, 1993. The expiration language for the exemption was inadvertently omitted from the gasoline tax statute when it was revised in 1985. To the knowledge of the Department of Revenue, this exemption has never been used. (Nonanhydrous ethanol is not used to make gasohol; it has a water content and, by its nature, cannot be mixed with gasoline.)

TAX SECRECY CHANGES

Sections 31 through 40 of this act reorganize and make both clarifying and substantive changes to the statutes governing confidentiality of government tax records. The substantive changes delete the authority of the Governor and of members of the General Assembly to have

access to confidential tax information, expand two existing exceptions to the prohibition against disclosing information (G.S. 105-259(b)(11) and (12)), add six narrow exceptions to the list of information that can be disclosed (G.S. 105-259(b)(13) through (18)), and remove information that is contained on a master application form submitted to the Business License Information Office of the Secretary of State from the definition of confidential tax information. The changes are described in more detail below.

Governor and General Assembly Members

This act deletes the authority of the Governor to have access to confidential tax information and deletes any right of access the members of the General Assembly may have to confidential tax information. Both former Governor Jim Martin and current Governor Jim Hunt concur with the change in the Governor's access.

Under former law, it was not clear whether members of the General Assembly had access to confidential tax information. G.S. 120-19, enacted in 1937, required all State agencies to furnish the General Assembly upon request "all information and data within their possession." The Revenue Act's secrecy provision, however, which was enacted in 1939, made no exception for members of the General Assembly. This act resolves this conflict by making it clear that members of the General Assembly do not have access to confidential tax information. The act therefore puts members of the General Assembly in the same position concerning this matter as the Governor.

Expanded Exceptions

The act expands the former exceptions to the prohibition against disclosure found in G.S. 105-259(b)(11) and (12). It expands the authorization to give one spouse information about the other spouse's income taxes when the spouses file a joint income tax return to include any joint return the couple files. In addition to filing joint income tax returns, spouses frequently file joint intangibles tax returns. Under former law, the Department could not give a copy of the intangibles tax return to a spouse who signed the return but did not have a copy of the return because the return discloses information about the other spouse.

The act expands the current exception for a financial institution to receive payments of withheld individual income taxes to include the transmittal of payments by electronic funds transfer. Chapter 450 of the 1993 Session Laws, summarized above, authorizes the Department of Revenue to initiate an electronic funds transfer payment program. That program cannot be initiated without this exception to the secrecy law.

New Exceptions

This act adds to the exceptions to the tax secrecy provisions the limited disclosures listed in G.S. 105-259(b)(13) through (18). Those disclosures are as follows:

(b)(13):Fiscal Research: Authorizes the Department of Revenue to give to the Fiscal Research Division of the General Assembly a sample of returns from which taxpayer identifying information has been removed so that the Division can prepare estimates of the effects of proposed changes in the law and conduct other research.

(b)(14):Department of Agriculture: Authorizes the Department of Revenue to share motor fuel tax information with the Department of Agriculture; the two agencies work together in administering motor fuel taxes and the Gasoline and Oil Inspection Act.

(b)(15):Excise Tax Information: Authorizes the Department of Revenue to exchange information on tobacco, soft drink, alcoholic beverage, or controlled substance excise

taxes with the North Carolina Alcoholic Beverage Control Commission, the Alcohol Law Enforcement Division of the Department of Crime Control and Public Safety, and the federal Bureau of Alcohol, Tobacco, and Firearms. Under former law, the Department of Revenue could not exchange information, other than lists of licensees, with these agencies.

(b)(16):Corporate Existence: Authorizes the Department of Revenue to give the Secretary of State names and identifying information of corporations to enable the Secretary of State to locate a corporation and notify the corporation that it is required to file an annual report.

(b)(17):License Application Status: Authorizes the Department of Revenue to give to the Business License Information Office of the Secretary of State information on the status of a license application for which the applicant has asked the License Office for assistance in coordinating. The License Office has the duty to assist and coordinate license applications but former law prohibited the Department of Revenue from disclosing information the Office needed to carry out this duty.

(b)(18):Vendor Location: Authorizes the Department of Revenue to give the State Controller names and identifying information of taxpayers to enable the State Controller to locate vendors who do business with the State and to track debtors of the State.

Master Business License Application Information

The act excludes information submitted to the Business License Information Office on a master application form from the definition of tax information. This change makes the information submitted on a master application form accessible to the various agencies that need to see the form to be able to process the applications included on the form and makes the information available to the public.

Clarifying Changes

In addition to making the substantive changes described above, the act makes several clarifying changes. It clarifies that local tax records containing information relating to a taxpayer's income or receipts are confidential and that other tax records, such as property tax records, are not confidential. It also makes conforming changes to various statutes and moves provisions that are unrelated to the disclosure of tax information from G.S. 105-259 (the secrecy provision of the Revenue Act) to more appropriate statutes.

Recommended by the Revenue Laws Study Committee.

1993 Chapter 494 (Senate Bill 1018, Sen. Ward)

AN ACT TO CLARIFY THAT REAL ESTATE MORTGAGE INVESTMENT CONDUITS WILL BE TREATED AS PASS-THROUGH ENTITIES FOR STATE TAX PURPOSES TO THE SAME EXTENT AS UNDER THE FEDERAL TAX LAW.

This act brings the State law into conformity with the federal tax law by exempting real estate mortgage investment conduits (REMICs) from corporate income taxes, franchise taxes, and the intangibles tax. A REMIC is an entity, usually a trust, that holds a pool of real estate mortgages for the benefit of investors who have invested in the entity. In concept, it is similar to a mutual fund that holds securities for the benefit of its investors. Current law already exempts

similar entities, regulated investment companies (RICs) and real estate investment trusts (REITs), from these taxes.

Federal law authorizes the creation of REMICs in order to facilitate investment in real estate mortgages. Since 1986, federal tax law has provided that a REMIC is not subject to federal income tax as an entity; instead, income from its mortgages is taxed directly as income of the investors. This makes a REMIC a pass-through entity: the income is "passed through" to the individual investors, rather than being taxed to the entity. A partnership, a mutual fund, a REIT, and a Subchapter S corporation are other types of pass-through entities.

North Carolina law does not specifically recognize REMICs as pass-through entities, although it does recognize other pass-through entities. The Department of Revenue interprets the current income tax law as allowing pass-through status for REMICs. It is not clear, however, whether the franchise tax law and the intangibles tax law would be interpreted in the same way. This act establishes with certainty the tax treatment of REMICs in North Carolina. This act becomes effective beginning with the 1993 tax year.

1993 Chapter 495 (Senate Bill 1111, Sen. Hoyle)

AN ACT TO ALLOW EACH OF THE MEMBERS OF THE FARMERS MUTUAL FIRE INSURANCE ASSOCIATION OF NORTH CAROLINA TO BE INDEPENDENTLY CHARTERED.

This act abolishes the Farmers Mutual Fire Insurance Association of North Carolina, which was established by an act of the General Assembly in 1893, and enables all the current branches of that association to convert to independently chartered mutual insurance companies. The act becomes effective January 1, 1994.

A current branch of the Farmers Mutual Fire Insurance Association that converts to an independently chartered mutual insurance company will be subject to the same taxes and fees as under current law. Thus, the bill makes no substantive change in the taxation of these companies. It makes one technical change, however, concerning the taxation of these companies. It deletes a reference in the insurance tax statutes to branches of the farmer's mutual assessment fire insurance company because, effective January 1, 1994, these companies will be independent companies and not branches of the same company.

1993 Chapter 497 (Senate Bill 1157, Sen. D. Winner)

AN ACT TO AMEND THE CONSTITUTION TO PERMIT CITIES AND COUNTIES TO ISSUE BONDS TO FINANCE THE PUBLIC PORTION OF ECONOMIC DEVELOPMENT PROJECTS AND TO AUTHORIZE COUNTIES AND CITIES TO ACCEPT AS CONSIDERATION FOR A CONVEYANCE OR LEASE OF PROPERTY TO A PRIVATE PARTY THE AMOUNT OF INCREASED TAX REVENUE EXPECTED TO BE GENERATED BY THE IMPROVEMENTS TO BE CONSTRUCTED ON THE PROPERTY.

This act gives counties and cities two different tools to enhance their ability to recruit and retain economic development. The first part of the act permits voters to vote on a constitutional amendment that will allow the General Assembly to enact general laws authorizing counties and cities to borrow money, without voter approval, to finance public activities associated with private economic development projects within a defined territorial area. This development tool, known as economic development financing, will allow local governments to set aside the additional property taxes that are generated by a new investment

to pay for public facilities that support that new investment. The second part of the act authorizes counties and cities to accept as consideration for a conveyance or lease of property to a private party the amount of increased tax revenue expected to be generated by the improvements to be constructed on the property. This part of the act became effective upon ratification, July 23, 1993.

The economic development financing bonds issue will be placed before the voters on Tuesday, November 2, 1993. The issue has been defeated by the voters once, on November 2, 1982. The Constitution needs to be changed to allow this because under the Constitution as it now reads the General Assembly does not have the power to authorize any unit of local government to issue bonds secured by its property tax revenue without a vote of the people.

If the amendment is approved, counties and cities may create a development financing district and adopt a development financing plan for that district. The total land area of the district may not exceed 5% of the total land area of the unit creating the district. The development financing plan describes the projects the unit of local government desires to finance and how the tax proceeds from the economic development financing bonds will be used. The plan must also include a description of how the proposed development, both public and private, will benefit the residents and business owners of the district in terms of jobs, affordable housing, and services. The plan must pass an environmental review and it must contain a requirement that initial users of a new manufacturing facility located in the district pay employees of the facility an average weekly manufacturing wage that is either above the average weekly manufacturing wage paid in the county where the district is located or is at least 10% above the average weekly manufacturing wage paid in the State. A plan may be exempt from the wage requirement if the Secretary of Commerce finds that unemployment in the county in which the district is located is especially severe.

If a county or city wants to issue economic development financing bonds to finance public activities associated with private economic development projects within a development financing district, it must have the approval of the Local Government Commission. The Commission cannot approve an application until the development financing district is created and the development financing plan is adopted. The bonds may be issued to finance parking facilities, sewer systems, solid waste disposal systems, storm sewers and flood control facilities, water systems, public transportation facilities, land development for industrial or commercial purposes, and redevelopment. Redevelopment includes purchasing and improving property to help local redevelopment commissions. Before approving the bond issuance, the Commission must find, among other things, that the proposed economic development financing bond issue is necessary to secure significant new economic development for a development financing district and that the private development forecast in the development financing plan would not be likely to occur without the public projects to be financed by the bonds.

To secure the bonds, the county or city issuing the bonds must establish a separate fund to account for the proceeds paid to it from taxes levied on the incremental valuation of the development financing district. The incremental valuation is the excess of the assessed value of taxable property in the district at the time the taxes are levied over the assessed value of property in the district at the time it was created. The Local Government Commission must find that the taxes on the incremental valuation, together with any proceeds that may be realized from the sale of property in the district and any revenues that may be realized from a public facility in the district, will be sufficient to service the economic development financing bonds. The district may remain in effect for 30 years or until the bonds are retired. The bonds must be

retired within 30 years or within the useful life of the projects financed, whichever is shorter. After that, all taxes are paid into the local general fund.

To provide additional security for the bonds, the county or city issuing the bonds may pledge the proceeds from the sale of property in the development financing district and the net revenues from public facilities in the development financing district constructed or improved under the development financing plan. The city or county may also pledge any other available sources of revenue as long as the agreement to use the sources to make payment does not constitute a pledge of the county's or city's taxing power. Other available sources of revenues that do not constitute a pledge of a county's or city's taxing power include taxes levied by the State that are transferred to a county or city, such as beer and wine tax revenues, utilities franchise tax revenues, and intangibles tax revenues.

The second part of the act authorizes counties and cities to estimate the amount of increased tax revenue that would accrue during the succeeding 10 years from economic development of a piece of property by the purchaser of the property and to accept the estimated amount as consideration for a conveyance of the property from the county or city to a purchaser that will bring the anticipated economic development. This same provision is contained in House Bill 1109, ratified as Chapter 536 of the 1993 Session Laws. Several cities and counties currently have this authority under local acts ratified over the past several years.

The county or city must determine that the conveyance of the property will result in the creation of a substantial number of jobs in the county or city that pay at or above the median average wage in the county or, for a city, in the county where the city is located. In accepting the consideration, the governing board of the county or city must contractually bind the purchaser of the property to construct, within five years, improvements on the property that will generate the tax revenue taken into account in arriving at the consideration. Upon failure to construct the improvements specified in the contract, the purchaser must reconvey the property back to the county or city.

1993 Chapter 507 (Senate Bill 659, Sen. Kaplan)

AN ACT TO PROVIDE THAT DEPOSITS ON RETURNABLE AERONAUTIC REPLACEMENT PARTS WILL BE TREATED THE SAME WAY AS DEPOSITS ON RETURNABLE AUTOMOTIVE, INDUSTRIAL, MARINE, AND FARM REPLACEMENT PARTS FOR SALES TAX PURPOSES.

State and local sales taxes are calculated as a percentage of the sales price of an item sold at retail. G.S. 105-164.3(16) defines sales price as the total amount for which an item is sold, with certain exceptions. Subpart e. of G.S. 105-164.3(16) provides that the sales price does not include refundable deposits paid by buyers on automotive, industrial, marine, and farm replacement parts that can be returned to the seller for rebuilding. Replacement parts do not include tires and batteries.

Effective August 1, 1993, this act extends this exception to provide that the sales price for sales tax purposes will not include refundable deposits paid by buyers on aeronautic replacement parts that can be returned to the seller for rebuilding. The anticipated loss to the General Fund is approximately $91,000 annually.

1993 Chapter 527 (House Bill 1359, Rep. Colton)

AN ACT TO ALLOW AN INCOME TAX CREDIT FOR EXPENDITURES TO REHABILITATE A CERTIFIED HISTORIC STRUCTURE.

This act allows a corporate and an individual income tax credit for qualifying rehabilitation expenditures, as defined under section 47 of the Internal Revenue Code, with respect to a certified historic structure located in North Carolina. The amount of the credit is equal to one-fourth of the federal income tax credit for qualifying rehabilitation expenditures. The federal credit is 20% of the qualifying rehabilitation expenditures. Therefore, for State tax purposes, the credit would equal 5% of the qualifying rehabilitation expenditures. However, the amount of the State tax credit cannot exceed the amount of tax due and any excess credit cannot be carried forward. The credit will be available for taxable years beginning on or after January 1, 1994.

A certified historic structure is a building that is listed in the National Register or that is located in a registered historic district and is certified by the Secretary of the Interior as being of historic significance to the district. A qualifying expenditure is one that can be chargeable to a capital account and for which a straight line depreciation is allowable. The expenditure must be in connection with the rehabilitation of a building and it must be consistent with the historic character of the property or the district in which the property is located. Qualifying expenditures do not include the cost of buying a structure or any expenditure attributable to the enlargement of an existing structure.

1993 Chapter 532 (Senate Bill 832, Sen. D. Winner)

AN ACT TO PROVIDE A TIMETABLE WITHIN WHICH THE DEPARTMENT OF REVENUE AND THE TAX REVIEW BOARD MUST HOLD ADMINISTRATIVE HEARINGS AND RENDER DECISIONS AND TO PROVIDE FOR STATE TAXPAYERS' RIGHTS.

This act makes numerous substantive and technical changes relating to administrative review in tax disputes and other tax enforcement and administration matters. Many of the changes were introduced by Representative Hackney in House Bill 1028, AN ACT TO PROVIDE FOR STATE TAXPAYERS' RIGHTS. The act is not expected to have any impact on State revenues. The act becomes effective January 1, 1994.

Timetable for Administrative Hearings

Sections 2, 3, and 10 through 12 of this act establish the timetable for administrative hearings by the Secretary of Revenue and the Tax Review Board on proposed and final tax assessments, requests for refunds, and allocation and apportionment of corporate income to this State for franchise tax and income tax purposes. If a taxpayer makes a timely, written request for a hearing, the Secretary or the Tax Review Board must schedule the hearing for a date within 90 days after the request and must notify the taxpayer within 60 days after the request and at least 10 days before the hearing. The hearing may be postponed at least once for up to 90 days, and longer upon the mutual agreement of the parties. The Secretary or the Tax Review Board is required to notify the taxpayer of the decision on the hearing within 90 days after the hearing. Under current law, there are no time limits within which a requested hearing must be scheduled or, after it is held, within which a decision must be made.

Notice of Final Assessment

Section 2 of this act requires the Secretary of Revenue to notify a taxpayer when a proposed assessment becomes final. The notice must include a statement outlining the procedure for levy on and sale of the taxpayer's property, administrative appeals and other options that are available to the taxpayer, and procedures to redeem the property and obtain release of a lien on the property. Under current law, a notice of a proposed assessment is required but, unless the taxpayer disputes the proposed assessment, there is no additional notice required when the assessment becomes final.

Jeopardy Actions

Sections 2, 3, and 4 of this act provide for special administrative and judicial review of jeopardy assessments and jeopardy levies. A jeopardy assessment is an immediate assessment of tax without the otherwise required 30 days' advance notice and opportunity for a pre-assessment hearing. The Secretary of Revenue is authorized to make a jeopardy assessment only if the Secretary finds that collection of the tax is in jeopardy and immediate assessment is necessary to protect the interest of the State. A jeopardy levy is an immediate filing of a lien against a taxpayer's property or an immediate execution against a taxpayer's personal property for an assessed tax without the required 30 days' advance notice and opportunity for a pre-levy hearing. After a taxpayer has requested a pre-levy hearing, the Secretary of Revenue is authorized to file a jeopardy lien upon determining that immediate action is necessary to protect the interest of the State and is authorized to cause a jeopardy execution against the taxpayer's personal property upon Secretary determining that collection of the tax would be jeopardized by delay. The taxpayer may prevent the execution by filing a bond for the amount of the assessed tax.

Sections 2 and 3 of this act provide that within five days after a jeopardy assessment or levy has been made, the Secretary of Revenue must provide the taxpayer a written statement of the information upon which the Secretary relied in making the assessment or levy. This statement is not required, however, if the jeopardy assessment or levy is of the controlled substances excise tax or is the result of a criminal investigation. These sections also provide that, upon request of a taxpayer against whom a jeopardy assessment or levy has been made, the Secretary must review the assessment or levy within 30 days to determine whether it was reasonable under all the circumstances. Section 4 of this act adds a new G.S. 105-241.5 to provide for special judicial review of jeopardy assessments and jeopardy levies made by the Department of Revenue. The taxpayer may bring an action in superior court, either in Wake County or in the county in which the taxpayer resides, for review of the reasonableness of the assessment or the levy. The court must make a determination within 20 days and may order appropriate relief.

Tax Collection Mechanisms

Section 5 of this act makes several changes to G.S. 105-242, which governs the collection of taxes by levy against and attachment and garnishment of taxpayers' property. First, this section provides that if the Department of Revenue has seized tangible property, the owner of the property may request the Secretary to sell the property within 60 or more days. Unless the Secretary determines that the requested sale would not be in the best interest of the State, the Secretary must authorize the sale. The Department of Revenue will retain the administrative expenses of selling property at the request of the property's owner.

Second, Section 5 requires the Secretary of Revenue to release a State tax lien if the liability for which the lien attached has been satisfied. Third, Section 5 authorizes the Secretary to release a State tax lien if (i) the underlying liability is unenforceable due to lapse of time,

(ii) the lien is creating an economic hardship due to the taxpayer's financial condition, (iii) release of the lien on the value of property that exceeds the value of the underlying liability would not hinder collection of that liability, or (iv) release of the lien would probably facilitate, expedite, or enhance the State's chances of collecting a tax. Fourth, Section 5 exempts from levy, attachment, and garnishment the taxpayer's principal residence (unless the Secretary approves the levy in writing or finds that collection of the tax is in jeopardy) and the taxpayer's personal property that is exempt from levy under the federal tax code. It does not change the existing exemption for 90% of a taxpayer's monthly pay.

Fifth, Section 5 prohibits the Secretary of Revenue from levying against property if the Secretary estimates that the cost of the levy would exceed the fair market value of the property. Finally, Section 5 requires the Secretary to review a tax lien if the taxpayer alleges that it was filed in error.

Installment Payments

Section 1 of this act authorizes the Secretary of Revenue to enter into an agreement with a taxpayer for payment in installments of a tax that has been assessed. The Secretary may enter into the agreement if the Secretary determines that the agreement will facilitate collection of the tax. As part of the agreement, the Secretary may waive tax penalties but may not waive any tax or interest due. The Secretary is authorized to modify or terminate the agreement if circumstances change or if the taxpayer has not provided accurate or complete information. Although current law does not speak to installment agreements, the Department Revenue already uses installment agreements under its general authority to facilitate tax collection.

Taxpayer Interviews

Section 7 of this act establishes the following rules governing taxpayer interviews with Department of Revenue personnel, other than interviews concerning a criminal investigation, the controlled substance excise tax, or a jeopardy assessment or levy. The taxpayer and the Department have the right to record an interview. If the Department records an interview, it must provide the taxpayer a transcript upon the taxpayer's request. The Department must provide the taxpayer, at or before the initial audit or collection interview, a written explanation of the audit process or the collection process, as appropriate, and of the taxpayer's rights during the process. The taxpayer may authorize another person to represent the taxpayer during the interview process by executing a power of attorney; the representative may appear instead of the taxpayer at the interview unless the Department has summoned the taxpayer. If, during an interview, the taxpayer wishes to consult with a representative, the Department must suspend the interview. Current law is silent on taxpayer interviews.

Taxpayer Bill of Rights

Section 6 of this act requires the Secretary of Revenue to publish annually and make available to taxpayers a statement of the taxpayer's bill of rights. This statement must set forth (i) the confidentiality of tax information; (ii) rights and obligations during an audit; (iii) procedures for appealing an adverse decision of the Department at each level, for claiming a refund, for requesting information, assistance, and interpretations, and for making complaints; (iv) penalties and interest that may apply and the basis for requesting waiver of a penalty; and (v) procedures the State may use to collect a tax, including assessment, jeopardy assessment, liens, and garnishment and attachment.

Evaluation of Tax Personnel

Section 8 of this act prohibits the Department of Revenue from using records of tax enforcement results, or production goals based on these records, as the sole criteria in evaluating Department personnel. Section 8 also requires the Department to consider records of taxpayer complaints naming a Department employee when evaluating that employee.

Reliance Upon Department's Tax Advice

Section 9 of this act provides that if a taxpayer requests in writing specific advice and receives from the Department erroneous written advice, the taxpayer is not liable for any penalty or additional tax assessment attributable to the taxpayer's reasonable reliance on the erroneous advice. This provision does not apply to the extent the penalty or additional tax assessment resulted from the taxpayer's failure to supply the Department adequate or accurate information. Under current law, taxpayers are entitled to rely upon interpretations and rules issued by the Department and currently in effect.

Annual Reporting on Taxpayer Services

Section 13 of this act requires the Department of Revenue to report annually to the Joint Legislative Commission on Governmental Operations regarding the quality of services provided to taxpayers.

1993 Chapter 536 (House Bill 1109, Rep. Baddour)

AN ACT TO AUTHORIZE COUNTIES AND CITIES TO ENGAGE IN ADDITIONAL LOCAL ECONOMIC DEVELOPMENT ACTIVITIES.

This act makes several changes in the law concerning local economic development. It authorizes counties and cities to spend public money for "site preparation" for industrial properties and facilities that are privately owned and to extend or finance the extension of water and sewer lines to industrial properties and facilities that are privately owned. It also authorizes counties and cities to estimate the amount of increased tax revenue that would accrue during the succeeding 10 years from improvements made to a piece of property and to accept the estimated amount as consideration for a conveyance of the property from the county or city to a business that will bring the anticipated economic development. Several local bills making these changes have been enacted since 1987 for individual cities and counties. This act makes the changes for all counties and cities in the State effective January 1, 1994.

Before a county or city may accept anticipated tax revenues as consideration for a conveyance of property, it must determine that the conveyance of the property will result in the creation of a substantial number of jobs in the county or city that pay at or above the median average wage in the county or, for a city, in the county where the city is located. In accepting the consideration, the governing board of the county or city must contractually bind the purchaser of the property to construct, within five years, improvements on the property that will generate the tax revenue taken into account in arriving at the consideration. Upon failure to construct the improvements specified in the contract, the purchaser must reconvey the property back to the county or city.

The change this act makes to the local economic development law was also made by Senate Bill 1157, ratified as Chapter 497 of the 1993 Session Laws. The change in Chapter 497 became effective upon ratification.

1993 Chapter 542 (Senate Bill 14, Sen. Perdue)

AN ACT TO AUTHORIZE THE ISSUANCE OF GENERAL OBLIGATION BONDS OF THE STATE, SUBJECT TO A VOTE OF THE QUALIFIED VOTERS OF THE STATE, TO PROVIDE FUNDS FOR (1) CAPITAL IMPROVEMENTS FOR THE UNIVERSITY OF NORTH CAROLINA, (2) GRANTS TO COMMUNITY COLLEGES FOR CAPITAL IMPROVEMENTS, (3) GRANTS, LOANS, AND REVOLVING LOANS TO LOCAL GOVERNMENT UNITS FOR WATER SUPPLY SYSTEMS, WASTEWATER COLLECTION SYSTEMS, WASTEWATER TREATMENT WORKS, AND WATER CONSERVATION PROJECTS, AND (4) CAPITAL IMPROVEMENTS AND LAND ACQUISITION FOR NEW AND EXISTING STATE PARKS AND RECREATION AREAS.

This act authorizes the issuance of $740 million in general obligation bonds of the State, if approved by the voters in a referendum to be held on Tuesday, November 2, 1993. The bonds are:

$310	million	University of North Carolina Improvements
$250	million	Community Colleges Improvements
$ 45	million	Deposit in Clean Water Revolving Fund
$100	million	Local Government Loans for Water and Sewer
$ 35	million	State Parks
$740	million	Total

The net cost to the General Fund of annual debt service on the above bonds should be about $59 million; this amount is lower than one might expect because the repayments of the $100 million in Water and Sewer loans can be applied toward debt service on the bonds.

The list of projects for the University of North Carolina provides at least one project for each constituent institution. The list is the same as that requested by the Board of Governors, with three exceptions: (i) the project for Fayetteville State University has been changed from a fine arts building to residence hall renovations at the request of the chancellor; (ii) the building for the N.C. School of the Arts Filmmaking School is specified as a production facility; and (iii) one of the projects for UNC-Asheville has been changed from Ramsey Library renovations to a conference center. The act also provides an additional $12 million for "other critical needs" of the University system, as determined by the Board of Governors.

If approved by the voters, the University Improvement bonds can be issued for the specified projects without further action by the General Assembly. If a project or an allocation later needs to be changed, due to a change of circumstances or another reason, the General Assembly has the power to make the change.

The Community Colleges Bond proceeds would be distributed in the form of grants to individual community colleges for building projects plus any related equipment and land acquisition. Like other appropriations to community colleges for capital projects, these grants would have to be matched with local funds on a dollar-for-dollar basis. Many of the colleges are "overmatched" to some extent, however; these colleges could use the overmatch to meet the matching requirement.

The act lists $226.1 million in specific projects for individual colleges and satellite campuses. Each community college has at least one project on the list. If approved by the voters, this part of the Community College bonds can be issued for the specified projects without further action by the General Assembly. If a project or an allocation later needs to be changed, due to a change of circumstances or another reason, the General Assembly has the power to make the change.

The act provides that the remaining $23.9 million in Community College bonds will be used for grants to be specified by the General Assembly in 1994 or later. This part of the bonds cannot be issued until the General Assembly allocates the funds for specific projects. It is intended that the allocations will be based on the recommendations of the Legislative Study Commission on Community College Capital Needs created in Section 11(a) of the act.

The Legislative Study Commission on Community College Capital Needs will consist of 10 voting members: 5 appointed by the Speaker of the House of Representatives and 5 appointed by the President Pro Tempore of the Senate. In addition, the President of the Community College System and the Chair of the State Board of Community Colleges will serve as ex officio, nonvoting members. The Study Commission is to study the issue of present and future capital needs of the Community College System and report its findings and recommendations to the General Assembly by April 1, 1994.

Of the $145 million Clean Water Bonds, $45 million is allocated to the existing Clean Water Revolving Loan and Grant Fund and $100 million is allocated for nonrevolving loans. This allocation is similar to that recommended to the 1993 General Assembly by the Legislative Research Commission's Water Issues Study Committee. If approved by the voters, the Clean Water bonds can be issued without further action by the General Assembly.

The $45 million will be used in the same way as funds in the Clean Water Revolving Loan and Grant Fund are used: to match federal funds for the 1993-95 biennium and to provide grants and low-interest loans. The sum of $45 million should be sufficient to provide the match for two years and to capitalize the revolving fund.

The act amends the Clean Water Revolving Loan and Grant Fund to increase the percentages of funds that will be used for grants to local governments without resources to repay loans, and to increase from $500,000 to $1,000,000 the maximum annual amount of a grant that can be made. Both of these changes are designed to help smaller, poorer communities obtain funding.

The other $100 million would all go out in loans to local government units for water supply systems, water conservation projects, wastewater collection systems, and wastewater treatment works. The funds would be allocated 69% for wastewater projects and 31% for water supply systems and water conservation projects. These percentages are based on the allocations in the existing revolving fund.

Local government units that may apply for loans include counties, cities, towns, sanitary districts, and water and sewer districts, as well as two or more of these units acting jointly. Priorities for the loans would be determined by the Department of Environment, Health, and Natural Resources, based on the priority factors for the existing revolving fund and on the need to create efficient regional systems. In addition, to qualify for a loan, a unit must have a water supply facility plan or a wastewater facility plan, as appropriate. The plan must be approved by the Department of Environment, Health, and Natural Resources.

The Department of Environment, Health, and Natural Resources will administer the making of loans, and the State Treasurer will determine the interest rate and maturity of the loans. The interest rates must reflect the self-supporting nature of the loan program: repayments must be sufficient to cover the State's debt service and costs of issuing and administering the bonds. The Department of Environment, Health, and Natural Resources is required to report annually in detail on this loan program to the Joint Legislative Commission on Governmental Operations.

Section 10 of the act provides the details of how the loan program will be administered. Local government units may submit applications on a semiannual basis but, before submitting an application, the unit must hold a public hearing. The Department of Environment, Health, and Natural Resources may hold additional public hearing and, if requested by affected members of the public, a referendum must be held on whether the unit will apply for a loan.

To be eligible for a loan, a local government unit must demonstrate that it has the financial capacity to repay the loan. In addition, in its loan agreement, the unit must authorize the State Treasurer to intercept any of its State funds distributions if it fails to make timely payments on a loan. This intercept provision will protect the State against default by a local government unit.

The act provides that $35 million of bonds would be used for the State Parks System for repairs, renovations, new construction, and land acquisition. However, no more than 30% of the bond proceeds may be used for land acquisition. If approved by the voters, the bonds could not be issued immediately; further action by the General Assembly is required in 1993 or later. It is intended that the General Assembly would appropriate the proceeds of the bonds in 1994 for specific projects based on a plan developed by the Department of Environment, Health, and Natural Resources. Section 11(b) of the act requires the Department of Environment, Health, and Natural Resources to develop a State parks capital improvement and land acquisition plan, which will include a priority list of needed land acquisitions and a priority list of needed repairs, renovations, and new construction. The priority lists are to be based on objective criteria. The Department of Environment, Health, and Natural Resources is to report this plan to the General Assembly by the first day of the 1994 Session.

Section 13 of the act modifies the law regarding refunding obligations. The former law, G.S. 142-29.5, authorized the State Treasurer, with the consent of the Council of State, to issue obligations to refund outstanding obligations. The law restricted the principal amount of the refunding obligations to the principal amount of the obligations being refunded. Section 13 provides an exception to this limitation: the principal amount of the refunding obligations may exceed the principal amount of the obligations being refunded if the refunding results in an aggregate debt service savings and the increase in the principal amount does not create cash-in-hand available for new capital improvements. This change will enable the State Treasurer to save money for the State through refinancing of outstanding debt.

Section 14 of the act states that the minority business participation goals set in G.S. 143-128 apply to projects undertaken with bond proceeds. The affected State agencies are required to monitor compliance and report annually to the General Assembly on the participation by minority businesses in the bond projects.

1993 Chapter 543 (Senate Bill 161, Sen. Kerr)

AN ACT TO ALLOW ALL TRAILERS TO OBTAIN MULTIYEAR LICENSE PLATES, TO INCREASE THE TYPES OF SPECIAL LICENSE PLATES, TO SPECIFY HOW FEES FROM THE NEW SPECIAL LICENSE PLATES ARE TO BE USED, TO MODIFY THE APPEARANCE OF THE SPECIAL LICENSE PLATE ISSUED TO MEMBERS OF THE NORTH CAROLINA GENERAL ASSEMBLY, AND TO MAKE TECHNICAL AND ADMINISTRATIVE CHANGES TO THE LAWS CONCERNING SPECIAL LICENSE PLATES.

This act makes technical changes and changes that conform the statutes to administrative practice in the laws governing multiyear trailer plates and special license plates. It also

authorizes several new special license plates, sets the fees for the new plates, and directs how the fees are to be distributed.

The act authorizes all trailers to obtain multiyear plates. It does not change the multiyear plate fee, which is $75, or the annual plate fee, which is $10. Although this change appears substantive, the Division of Motor Vehicles is currently allowing all trailers to obtain multiyear plates even though the law states that a multiyear plate can be obtained only for a semitrailer. Thus, this change conforms the statute to the administrative practice.

The act also makes a conforming change to the statute that specifies which motor vehicles are to be listed with the county tax assessor for purposes of local property taxes and which are not. It adds trailers that receive multiyear plates to the list of vehicles that must be listed annually with the local assessor. These vehicles must be listed annually because the multiyear plate takes them out of the annual vehicle registration renewal process. It is this annual vehicle registration that triggers payment of property taxes for those vehicles that are subject to the new system for collecting property taxes on motor vehicles and thus do not have to be listed locally.

The act authorizes several new special license plates. Special license plates are optional license plates that can be obtained in lieu of the regular license plates. The most popular of these plates are collegiate plates and personalized plates.

All of the new plates authorized by this act are subject to the same $10 additional fee that applies to practically all other special plates. That $10 additional fee is credited to the Special Registration Plate Account. Some of the new plates authorized are designed as a fund-raiser and are subject to a higher additional fee. Except for new plates authorized for groups that do not and never will include 300 members, the act requires at least 300 applications for each new plate before the plate can be issued. The two plates added that cannot and likely never will include 300 members are the Legion of Valor plate and the Register of Deeds plate. The new plates authorized by the act are listed below:

(1) American Legion. -- Issuable to a member or supporter of that organization.

(2) Civic Club. -- Issuable to a member of a nationally recognized civic organization whose member clubs in North Carolina are exempt from State corporate income tax under G.S. 105-130.11(a)(5).

(3) County Commissioner. -- Issuable to a county commissioner.

(4) Future Farmer of America. -- Issuable to a member or supporter of that organization.

(5) Legion of Valor. -- Issuable to a recipient of one of the following military decorations: the Congressional Medal of Honor, the Distinguished Service Cross, the Navy Cross, or the Air Force Cross. The plate for the Congressional Medal of Honor has been authorized for some time as a free plate. Although this act does not change this, it does impose the standard special plate fees on the other Legion of Valor plates. This is in keeping with the policy set by the 1991 General Assembly when it established standard provisions for special license plates. The special license plate statutes were rewritten in 1991 and standard fees were applied to all but a few plates that had historically been free of charge.

(6) Register of Deeds. -- Issuable to a register of deeds.

(7) Special Olympics. -- Issuable to any vehicle owner. This plate is designed as a fund-raiser. The fee for the special plate is an additional $25. Fifteen dollars of the additional $25 fee goes to the North Carolina Special Olympics.

(8) State Attraction. -- Issuable to any vehicle owner. The State Attraction plates authorized by this act are The North Carolina Arboretum and The North Carolina Zoological Society. These plates are designed as a fund-raiser. The fee for these special plates is an additional $30. Twenty dollars of the additional $30 fee derived from The North Carolina Arboretum special plate goes to The North Carolina Arboretum Society. Twenty dollars of the additional $30 fee derived from The North Carolina Zoological Society special plate goes to The North Carolina Zoological Society.

(9) Veterans of Foreign Wars. -- Issuable to a member or supporter of the organization.

(10) Wildlife Resources. -- Issuable to any vehicle owner. This plate is designed as a fund-raiser. The fee for this special plate is an additional $20. Ten dollars of the additional $20 fee goes to the Wildlife Conservation Fund.

The act makes several changes to the statutes concerning special license plates. These changes are listed below:

(1) Limits the "Horseless Carriage" special license plate to a vehicle that is a model year 1943 or older. However, the owner of a vehicle that is a model year 1943 or older may elect to have the special plate bear the phrase "Antique". The statute retains the definition of an "Antique" vehicle as a vehicle that is at least 35 years old from the date of manufacture.

(2) Deletes the requirement that a person be licensed by the Federal Communications Commission (FCC) as a Class D Citizen's Radio Station Operator to be eligible for the Class D Citizen's Radio Station Operator special plate because the FCC has not issued licenses for these operators since April 27, 1983. The form of the plate is also changed to reflect the fact that some operators do not have official call letters.

(3) Corrects the spelling of the word "Consular".

(4) Requires that "The Great Seal of the State of North Carolina" be displayed on the plates issuable to members of the North Carolina General Assembly. This change applies beginning with plates issued to legislators serving in the 1995 General Assembly.

(5) Changes the form of the retired military plate to reduce the number of words the plate must display and to require the plate to display the appropriate insignia. It also requires at least 300 people to apply for a retired military plate before the plate can be issued. As of January 1, 1993, the Division had received only one request for this plate.

(6) Allows the surviving spouse of a person who had a prisoner of war plate to keep the plate until that spouse remarries or does not renew the plate. This authorization was deleted from the law in 1991, but the Division has continued to allow the surviving spouses of prisoners of war to keep these plates.

(7) Requires at least 300 people to apply for a street rod plate before the plate can be issued. During calendar year 1992, the Division received fewer than 20 applications for these plates.

1993 Chapter 544 (Senate Bill 853, Sen. Kerr)

AN ACT TO AUTHORIZE CERTAIN COUNTIES THAT WILL DERIVE ECONOMIC BENEFITS FROM THE NORTH CAROLINA GLOBAL TRANSPARK TO FORM A GLOBAL TRANSPARK

DEVELOPMENT ZONE TO PROMOTE ECONOMIC DEVELOPMENT OF, AND TO ENCOURAGE INFRASTRUCTURE CONSTRUCTION IN, THE COUNTIES OF THE ZONE.

This act authorizes the following counties that would derive economic benefits from the North Carolina Global TransPark to join together to create an economic development district: Carteret, Craven, Duplin, Edgecombe, Greene, Jones, Lenoir, Nash, New Hanover, Onslow, Pamlico, Pitt, Wayne, and Wilson. The district will be known as the Global TransPark Development Zone. The North Carolina Global TransPark is a large industrial area planned to surround an air cargo and air transportation complex in Lenoir County, to be called the North Carolina Global TransPark Complex.

A minimum of three counties are required to create the Zone. To create the Zone, the counties that wish to participate must, after July 24, 1993, but before October 2, 1993, adopt resolutions stating their intent to create the Zone. Each participating county must hold a public hearing before adopting the resolution. The resolutions must be forwarded to the Secretary of State by October 15, 1993; the Secretary of State will then issue a certificate of incorporation that will constitute the Zone as a public body.

The governing body of the Zone will be the Global TransPark Development Commission, with the following membership:

-- Each county that creates the Zone will appoint three voting members, at least one of whom must be a woman or a member of a racial minority and one of whom may be a member of the board of commissioners of the county.

-- The Global TransPark Authority will appoint between three and seven voting members, the minimum number necessary to assure that the voting membership of the Commission includes at least seven women and seven members of a racial minority.

-- Four additional nonvoting members will be appointed, one by the chancellor of East Carolina University, one by the presidents of the community colleges in the Zone, one by the State Ports Authority, and one by the Global TransPark Foundation, Inc.

The Zone is authorized to levy a temporary $5.00 registration tax on motor vehicles with a situs within the Zone. The Zone must hold a public hearing before adopting a resolution levying the tax. The tax may not become effective before July 1, 1994, and expires five years after the effective date of the first tax levied by the Zone. The amount of revenue generated by the tax depends on how many counties join the Zone, but is not expected to exceed $3.7 million a year in any case.

The proceeds of the tax, and any other funds of the Zone, would be used to carry out the Zone's purpose:

> To promote the development of the North Carolina Global TransPark and to promote and encourage economic development within the territorial jurisdiction of the Zone by fostering or sponsoring development projects to provide land, buildings, facilities, programs, information and data systems, and infrastructure requirements for business and industry in the North Carolina Global TransPark outside of the Global TransPark Complex, or elsewhere in the Zone.

The funds could not be used for projects carried out within the actual four to six thousand acre site of the Global TransPark Complex. Eighty-five percent of the tax proceeds must be kept in a trust account of which the participating counties are the beneficial owners. The principal of the account may be used only for loans. If the Zone is terminated or is otherwise unable to expend the tax proceeds, the tax proceeds and the other assets of the Zone will go back to the

participating counties in proportion to the amount of tax collected in each county, except that any funds attributable to a State appropriation will revert to the State.

The Zone's powers to carry out its purpose include the following local development powers currently granted local governments in G.S. 158-7.1 (except that the Zone may not levy a property tax):

(1) To make appropriations to aid and encourage the location of manufacturing enterprises.

(2) To acquire and develop land for an industrial park.

(3) To acquire and hold for resale property suitable for industrial or commercial use.

(4) To extend utility services to an industrial facility.

(5) To acquire property and convey or lease it to private interests for fair market value, which value would be determined after taking into account future potential revenue gains from the development.

The Zone also has the power:

(1) To make loans and grants to carry out its economic development activities.

(2) To acquire or support public infrastructure systems or facilities.

(3) To provide employee training programs.

(4) To maintain a clearinghouse of economic data and business information.

(5) To prepare site studies and provide businesses opportunities to examine sites.

Chapter 561 of the 1993 Session Laws, the Capital Improvements Appropriations Act of 1993, appropriates $7.5 million to the Global TransPark Development Zone to be used in the same way as the proceeds of the motor vehicle registration tax: for economic development projects and infrastructure construction projects within the Zone. Section 72 of that act places a number of restrictions on these funds. First, the appropriation will be placed in the same interest-bearing trust account as 85% of the tax and will be subject to the same restrictions. Second, the funds must be matched with non-State funds or property contributed, on or after July 1, 1993, to the Global TransPark Foundation, Inc. Third, the funds may not be distributed until after the effective date of the motor vehicle registration tax. Thus, the Zone must be created and the tax must be levied and become effective before the appropriation can be distributed. Finally, if the Zone terminates, the funds will revert to the General Fund.

1993 Chapter 548 (House Bill 83, Rep. DeVane)

AN ACT TO TEMPORARILY INCREASE THE SCRAP TIRE DISPOSAL TAX, TO PROVIDE FOR THE DISTRIBUTION OF THE ADDITIONAL TAX PROCEEDS, TO TEMPORARILY REVOKE THE GENERAL AUTHORITY OF A UNIT OF LOCAL GOVERNMENT OR A CONTRACTING PARTY TO IMPOSE A SEPARATE SCRAP TIRE DISPOSAL FEE, AND TO AUTHORIZE THE DEPARTMENT OF ENVIRONMENT, HEALTH, AND NATURAL RESOURCES TO DEVELOP

AND IMPLEMENT ALTERNATIVE, MARKET-BASED PILOT PROGRAMS FOR SCRAP TIRE COLLECTION AND RECYCLING.

This act makes several changes to the scrap tire tax and the distribution of the proceeds of that tax. It temporarily increases the scrap tire tax from 1% to 2% for tires that have a bead width of less than 20 inches, temporarily changes the distribution of the scrap tire tax proceeds, temporarily prohibits local governments from charging an additional fee for processing scrap tires, and permanently limits the amount of scrap tire tax proceeds the Department of Revenue can retain for its administrative expenses in collecting and distributing the tax. The restriction on local scrap tire fees becomes effective January 1, 1994. The other changes become effective October 1, 1993. The temporary changes expire June 30, 1997.

From October 1, 1993, through June 30, 1997, the act increases the scrap tire tax from 1% to 2% for tires that have a bead width of less than 20 inches. The tax remains at 1% for tires that have a bead width of at least 20 inches. Bead width is the width of the inside opening of the tire. Tires for cars, vans, and pick-up trucks have a bead width of less than 20 inches. The tax increase is expected to increase scrap tire tax proceeds by approximately $3.3 million each year it is in effect.

From October 1, through June 30, 1997, the act also changes the distribution of the scrap tire tax. Under current law, 10% of the proceeds goes to the Solid Waste Management Trust Fund and 90% goes to the counties on the basis of population. Effective October 1, 1993, the act reduces from 10% to 5% the amount of the proceeds that go to the Solid Waste Management Trust Fund, reduces from 90% to 68% the amount of the proceeds that go the counties, and puts the remaining 27% of the proceeds in the newly created Scrap Tire Disposal Account.

The Department of Environment, Health, and Natural Resources will administer the Scrap Tire Disposal Account. The Department may use up to $500,000 of the revenue in the Account during the 1993-95 biennium to conduct a pilot program on alternative, market-based approaches to scrap tire collection and recycling, may use up to 25% of the revenue in the Account for the duration of the temporary tax to make grants to eligible local governments for the disposal of scrap tires, and must use the remainder to clean up nuisance tire collection sites. The Department must report quarterly to the Environmental Review Commission on the use of revenue in the Account.

A local government is eligible for a grant if its cost for scrap tire disposal for the most recent 6-month period exceeds the amount it received for that period from the 68% of the proceeds that are distributed on the basis of population. To obtain a grant, an eligible local government must apply for a grant and be selected by the Department based on criteria established by the Department. The criteria, however, must include the local government's financial ability to provide for scrap tire disposal, the severity of the local government's scrap tire disposal problem, and the effort made by the local government to provide for scrap tire disposal within the resources available to it.

Until June 30, 1997, the act prohibits a local government from charging a fee for the disposal of scrap tires except for two kinds of scrap tires. They are new tires that are defective and therefore cannot be sold and tires that are brought from another state to a disposal site in North Carolina.

The act permanently caps at $225,000 the annual amount of scrap tire tax proceeds the Department of Revenue can retain to cover the cost of collecting and administering the tax. Current law allows the Department to retain its costs and does not cap the amount allowed.

Recommended by the Solid Waste Control and Disposal Issues Study Committee.

1992

Prepared by Cynthia Avrette, Sabra J. Faires, and Martha H. Harris

1992 Chapter 812 (House Bill 1245, Rep. Nesbitt)

AN ACT TO MAKE MODIFICATIONS IN THE BASE BUDGET AND EXPANSION BUDGET APPROPRIATIONS FOR CURRENT OPERATIONS OF STATE DEPARTMENTS, INSTITUTIONS, AND AGENCIES, FOR THE 1992-93 FISCAL YEAR, TO EXTEND CERTAIN EXPIRING BUDGET PROVISIONS, AND FOR OTHER PURPOSES.

Section 9 of this act provides a mechanism to either increase or decrease the amount of revenue in the Reserve for Reimbursements to Local Governments and Shared Tax Revenues when more or less revenue than was appropriated to that Reserve is needed to make the distributions from the Reserve that are required by law. If more revenue than was appropriated is required in a fiscal year, the difference is to be transferred from the General Fund to the Reserve. Conversely, if less revenue than was appropriated is required in a fiscal year, the excess in the Reserve reverts to the General Fund.

The section applies retroactively to July 1, 1991. Less revenue was appropriated to the Reserve for fiscal year 1991-92 than was required to be distributed to local governments from the Reserve for that year. To make the required distributions from the Reserve, the amount of the deficiency was taken from the General Fund. Thus, this section conforms the law to the actions taken in fiscal year 1991-92 concerning the Reserve and avoids a similar problem in the future.

The Reserve for Reimbursements to Local Governments and Shared Tax Revenues was established to be the revenue source for distributions to local units of government for reimbursements made to them by the State for various repealed local taxes and for distributions made to them based on the amount of various State tax collections. Chapter 993 of the 1991 Session Laws, which is explained in this document, changed the method for making the reimbursements from an appropriation to an automatic allocation of part of the State corporate income tax. Therefore, effective for the 1992-93 fiscal year, the Reserve contains only the revenue needed to make the distributions to local units of government based on collections of the following State taxes: the intangibles tax (G.S. 105-213); beer and wine excise taxes (G.S. 105-113.82): and the corporate franchise tax on natural gas companies, power companies, and telephone companies (G.S. 105-116 and G.S. 105-120).

1992 Chapter 814 (Senate Bill 972, Sen. Lee)

AN ACT TO PERMIT PUBLIC TRANSPORTATION AUTHORITIES AND REGIONAL PUBLIC TRANSPORTATION AUTHORITIES TO RECEIVE ANNUAL SALES TAX REFUNDS.

This act adds two types of local public transportation authorities to the list of governmental entities that may apply for an annual refund of State and local sales and use taxes paid directly or indirectly on items purchased by the entity. The two types added are local public transportation authorities created under Article 25 of Chapter 160A of the General Statutes and regional public transportation authorities created under Article 26 of Chapter 160A of the General Statutes. The local public transportation authorities affected by the bill consist primarily of a single county authority or a multi-county authority. The only regional public

transportation authority, and the only one that can be created under the statutes, is the Triangle Transit Authority, which consists of Wake, Durham, and Orange Counties.

Several local public transportation authorities that are organized other than under Article 25 of Chapter 160A currently receive sales and use tax refunds. Some transportation authorities are organized in city charters, some are created by special act, and some are organized under the public enterprise laws. Those organized in one of these ways are considered extensions of the city or county and, as part of the city or county, receive sales and use tax refunds.

In addition to all counties and incorporated cities and towns, there are 15 other, primarily local, governmental entities currently entitled to refunds of State and local sales and use taxes. In addition to this act, Chapter 917 of the 1991 Session Laws added WTVI Channel 42 in Charlotte to this list of governmental entities entitled to an annual refund of sales and use taxes.

The governmental entities must apply for the refund within six months after the end of each fiscal year. This act became effective upon ratification, July 1, 1992, so the public transportation authorities can obtain a refund for sales and use taxes paid during the 1992-93 fiscal year and subsequent years. The act is expected to reduce General Fund revenues by no more than $33,000 annually and local government revenues by approximately $17,000 annually.

Recommended by the Railroads and other Public Transportation Study Committee.

1992 Chapter 857 (Senate Bill 185, Sen. Block)

AN ACT CONCERNING THE TAXATION OF CORPORATIONS THAT ATTRIBUTE PART OF THEIR INCOME FROM THE SALE OF CERTAIN EXPORT PROPERTY TO A FOREIGN SALES CORPORATION.

This act establishes the portion of income attributed to a foreign sales corporation that must be included in the State taxable income of the corporation whose income was attributed to the foreign sales corporation. The portion of attributed income that must be included in State taxable income under this act is the portion of the attributed income that the foreign sales corporation was required to include in its federal taxable income. Thus, under the act, if a corporation attributes $100 in profit from export sales to a foreign sales corporation under section 925 of the Internal Revenue Code and the foreign sales corporation is required to include $30 of this $100 of attributed income in its federal taxable income, the corporation must add back to its federal taxable income the sum of $30 to derive its State taxable income.

Before the enactment of this act, the law on this topic was unclear. Without a specific add back, a corporation could argue that none of the corporation's income that was attributed to a foreign sales corporation was subject to tax by North Carolina because the income was not included in the corporation's federal taxable income, which is the starting point for computing State taxable income, and no provision in State law required an adjustment. Unlike the federal government, the State cannot tax the foreign sales corporation because, by definition, a foreign sales corporation is a kind of foreign corporation over which the State has no jurisdiction and therefore no authority to tax as a separate entity.

The Code provisions allowing for the creation of foreign sales corporations and the attribution of income to them provide a way for the federal government to indirectly subsidize export sales of goods made in the United States. A foreign sales corporation is a corporation

created by a parent or other related corporation for the purpose of making export sales of the parent's or other related corporation's goods or services. The parent or other related corporation can use one of three formulas set by the Code to attribute income from the sale of exports to the foreign sales corporation and part of the attributed income is exempt from the federal taxable income of the foreign sales corporation.

In 1987, the General Assembly passed a law that, in practice, accomplished the same purpose as this act. The law expired on December 31, 1991. The changes made by this act became effective for taxable years beginning on or after January 1, 1992. Thus, there will be no gap between the original provision and the new provision.

1992 Chapter 867 (House Bill 1320, Rep. Gamble)

AN ACT TO CLARIFY THAT THE SCRAP TIRE DISPOSAL TAX DOES NOT APPLY TO NEW TIRES PLACED ON NEWLY MANUFACTURED VEHICLES.

This act provides that new tires purchased for placement in this State on newly manufactured vehicles are exempt from the scrap tire disposal tax imposed by Article 5B of Chapter 105 of the General Statutes. The 1991 revision of the scrap tire disposal tax had inadvertently included these tires within the scope of the tax. The act became effective July 15, 1992.

The scrap tire disposal tax is a 1% tax on the price of certain tires. It was first enacted in 1989 and was revised by Chapter 221 of the 1991 Session Laws. When first enacted, the tax applied only to new motor vehicle tires sold at retail. As revised in 1991, the tax applied, with a few narrow exceptions, to all new vehicle tires sold at retail and to some new vehicle tires sold at wholesale.

The intent of the scrap tire disposal tax is to tax a tire that replaces a tire that is removed from a vehicle and is therefore in need of disposal. When a new tire is placed on a newly manufactured vehicle, no tire is being replaced and no tire is in need of disposal. Thus, imposition of the scrap tire disposal tax in this situation is not consistent with the intent of the tax. In creating the new exemption for tires purchased for placement on newly manufactured vehicles, the General Assembly accepted the finding of the Revenue Laws Study Committee that the 1991 revision of the scrap tire disposal tax did not intend to include new tires placed on newly manufactured vehicles.

This act will not affect the General Fund because the proceeds of the scrap tire disposal tax are not credited to the General Fund. Ten percent of the revenue from the tax is deposited in the Solid Waste Management Trust Fund and the other ninety percent is distributed to the counties on a per capita basis to be used for the disposal of scrap tires or the abatement of a nuisance caused by storing scrap tires. The act is expected to reduce the scrap tire disposal tax proceeds, but the amount of the reduction is not known.

Recommended by the Revenue Laws Study Committee.

1992 Chapter 900 (House Bill 1340, Rep. Nesbitt)

AN ACT TO MODIFY THE APPROPRIATIONS AND BUDGET REVENUE ACT OF 1991, AS AMENDED, AND TO MAKE OTHER CHANGES IN THE BUDGET OPERATION OF THE STATE.

Section 20 of this act establishes a permanent procedure for the disposition of the proceeds of the tax imposed by Article 2D of Chapter 105 of the General Statutes on illegal drugs, which the law refers to as controlled substances, and eliminates the temporary procedure that has been in effect since the tax became effective on January 1, 1990. The change became effective July 1, 1992.

Under the new procedure, the proceeds of the illegal drug tax are temporarily credited to a newly-created, nonreverting State Controlled Substances Tax Account. All of the tax proceeds that are the result of voluntary compliance with the tax rather than an assessment against a drug dealer are transferred from the Account to the General Fund. The tax proceeds that are the result of an assessment against a drug dealer are shared by the State and the State or local law enforcement agency that conducted the investigation that led to the assessment. When a drug dealer who pays an assessment no longer has the legal right to challenge the assessment, 25% of the proceeds from the assessment is transferred from the Account to the General Fund and the other 75% is transferred from the Account to the appropriate State or local law enforcement agency. Amounts transferred to the General Fund are not restricted in their use.

Under the old procedure, the proceeds of the tax were credited to the State Controlled Substances Tax Fund created by Section 6 of Chapter 772 of the 1989 Session Laws. As under the new procedure, 75% of the tax proceeds that were the result of an assessment against a drug dealer were transferred from the Fund to the State or local law enforcement agency that conducted the investigation that led to the assessment when the drug dealer who paid the assessment no longer had the legal right to challenge the assessment. Unlike under the new procedure, however, the rest of the tax proceeds remained in the Fund and, as directed by Chapter 772 of the 1989 Session Laws, were to continue to remain in the Fund until the General Assembly transferred the proceeds to the General Fund.

Section 20 of this act makes that contemplated transfer. It transfers the accumulated tax proceeds in the State Controlled Substances Tax Fund that are not earmarked for remittance to a law enforcement agency from that Fund to the General Fund, abolishes the State Controlled Substances Tax Fund, and requires $594,158 of the amount transferred to be applied in the 1992-93 fiscal year to the cost of administering the tax.

1992 Chapter 913 (Senate Bill 1011, Sen. Winner)

AN ACT MAKING TECHNICAL AND OTHER CHANGES TO THE FUEL TAX LAWS.

This act makes several unrelated substantive changes to the fuel tax laws and also makes several technical changes to these laws. Most of the substantive changes concern the road tax imposed on motor carriers; the remaining substantive changes concern receipts for retail sales of special fuel and the income tax credit for construction of a fuel ethanol distillery.

Chapter 441 of the 1991 Session Laws had deleted the requirement in former G.S. 105-449.26 that a seller of special fuel keep a record of and give a receipt for each retail sale of the fuel and substituted a requirement that a seller of special fuel keep a record of and give a receipt for all sales of 25 gallons or more of fuel for highway use and for all sales of any amount of fuel for nonhighway use. Although this change reduced the circumstances in which a seller of special fuel had to keep a record of and give a receipt for a retail sale of fuel, sellers continued to report problems with the law to the Department of Revenue. To keep the

type of record and give the type of receipt required, the seller had to know the name and address of the person buying the fuel and other information about the buyer. In some cases, buyers of fuel would refuse to give the required information and became angry. In the case of special fuel sold at marinas for use in watercraft, sellers complained that the paperwork was unnecessary because the pump was located in a place, such as the end of a marina, where it would be used only to dispense fuel for nonhighway use. Effective July 10, 1992, Section 7 of Chapter 913 makes the following changes to G.S. 105-449.26 in response to these complaints:

(1) It deletes the requirement that a seller keep a record of and give a receipt for all sales of 25 gallons or more of special fuel for highway use and substitutes a requirement that a seller keep a record of and give a receipt for any amount of special fuel sold for highway use only when the buyer asks for a receipt.

(2) It deletes the requirement that a seller give a receipt for every sale of any amount of special fuel sold for nonhighway use and, instead, requires a receipt to be given only when requested by the buyer. It retains the requirement that the seller keep a record of all of these sales, however.

(3) It requires that a record of and a receipt for a sale of special fuel for nonhighway use include the type of container or equipment into which the fuel was dispensed.

(4) It requires a seller of special fuel at a marina whose fuel pump is located at a place that makes it improbable that fuel could be dispensed from the pump into a motor vehicle to keep a record of and give a receipt for a sale of fuel only when the buyer asks for a receipt for the sale.

Sections 14 and 15 of the act extend the expiration dates of the corporate and individual income tax credits for construction of a fuel ethanol distillery from January 1, 1994, to January 1, 1996. These tax credits are designed to provide an incentive for a person to construct a distillery to make ethanol from agricultural or forestry products for use as fuel for motor vehicles or airplanes, for use as a de-icer, or for use in removing pollutants from coal or other fuel sources. The expiration dates were extended because it was believed that construction of such a distillery would take place as a result of the incentives, but not until after January 1, 1994.

The rest of the substantive changes made by this act, which are contained in Sections 8 through 11, affect motor carriers and their liability for the road tax. In general, motor carriers are operators of large trucks and the road tax is a tax on the amount of fuel a motor carrier uses in its operations in this State.

Section 8 changes the definition of motor carrier to conform to proposed changes in the International Fuel Tax Agreement (IFTA). As a result of Chapter 487 of the 1991 Session Laws, North Carolina became a member of the IFTA on January 1, 1992. To join the IFTA, a state must agree to certain uniform provisions. When North Carolina joined the IFTA, the definition of motor carrier in G.S. 105-449.37(a) met the requirements of the IFTA. Because of proposed changes to the IFTA definition of motor carrier, however, the definition of motor carrier in G.S. 105-449.37 before amendment by this act would not have met the requirements of the IFTA as of January 1, 1993. Effective July 10, 1992, this act ties the definition of motor carrier in State law to the definition used by the IFTA. The immediate effect of this change is to include within the definition of motor carrier a person who operates a combination vehicle whose registered gross vehicle weight exceeds 26,000 pounds. Although the change also appears to delete the exception for recreational vehicles, this deletion has no practical effect because recreational vehicles are not qualified motor vehicles under the IFTA. Section 8 is not expected to have a

noticeable impact on Highway Fund or Highway Trust Fund revenues because it does not significantly increase the number of vehicles subject to the road tax.

Section 9 of this act addresses a problem of lessee liability for compliance with the road tax and with other provisions specific to motor carriers. Under G.S. 105-449.42A(b), a person who leases a motor vehicle from an independent contractor for fewer than 30 days cannot choose to be the motor carrier; the independent contractor is always the motor carrier in that circumstance. Nevertheless, former G.S. 105-449.42A(c) made the lessee jointly liable with the independent contractor for compliance with the road tax and other motor carrier provisions. Based on a finding by the Revenue Laws Study Committee that it was not fair to hold a person liable for compliance with a law when someone else has the sole legal duty to comply with the law, Section 9 of this act relieves a lessee of a motor vehicle who legally cannot choose to be the motor carrier with respect to that vehicle from liability for compliance with the motor carrier laws. This change became effective July 10, 1992.

Sections 10 and 11 of this act change the amount of the fee charged for a temporary motor carrier permit and the amount of a civil penalty that can be imposed on a motor carrier for operating in this State without proper registration. Section 10 increases the temporary motor carrier permit fee from $25 to $50 and Section 11 increases the civil penalty from $75 to $100, thereby maintaining the current $50 difference between the fee and the penalty. Before this change, the temporary permit fee had not been increased since it was established in 1982 and the civil penalty had not been increased since 1981, when it was raised from $25 to $75. The increases in the fee and penalty became effective September 1, 1992, and are expected to increase Highway Fund revenues by approximately $650,000 each year.

A temporary permit authorizes a motor carrier to operate in the State for 20 days without reporting mileage to the Department of Revenue and paying the road tax based on the number of miles driven. When the former $25 permit fee was set in 1982, the per gallon fuel tax was 12¢ and, consequently, each $25 of road tax liability equaled approximately 208 gallons of fuel and 1,040 miles driven. The per gallon tax is now 22.3¢ and each $25 of road tax liability equals approximately 112 gallons of fuel and 560 miles driven. To put this mileage in context, one round trip up and down I-85 within North Carolina is approximately 468 miles. Thus, the State was losing road tax revenue each time a person with a temporary permit made two round trips up and down I-85.

Section 10 also makes another change designed to avoid a revenue loss through the use of temporary permits. It gives the Secretary of Revenue the authority to refuse to issue a temporary permit to a motor carrier whose road tax registration has been withheld or revoked or who the Secretary finds is evading payment of the road tax through the use of temporary permits.

In addition to the substantive changes described above, this act makes a number of technical corrections set out in Sections 1 through 6 and Sections 12 and 13. Unless otherwise noted in this explanation, the technical corrections became effective upon ratification of the act, July 10, 1992.

Section 1 adds standard definitions of "person" and "Secretary" to the gasoline tax article, Article 36 of Chapter 105 of the General Statutes. Section 2 eliminates an unnecessary reference to a fuel tax refund for the Department of Transportation. The Department of Transportation no longer receives refunds because sales of fuel to the Department became exempt from fuel tax under G.S. 105-449A beginning August 1, 1991.

Section 3 deletes a statute, G.S. 105-442, that was no longer needed because its provisions were either repeated elsewhere in the statutes or not used. The provisions in G.S. 105-442 on suits to enforce payment of fuel taxes were repeated in G.S. 105-239, which is made applicable to the fuel tax laws by G.S. 105-269.3. The provision concerning double liability when a court finds that a person willfully failed to pay fuel tax had never been used; instead, the general penalties in G.S. 105-236 have been applied. The provision on revocation of a distributor's license was repeated in G.S. 105-441(b).

Sections 4, 5, and 6 of the act correct redlining errors that caused the word "tax" to be in the wrong place in G.S. 105-445. That statute appears in each of those sections because there are three versions of the statute with different effective dates. The effective dates of these technical corrections match the effective dates of the different versions of G.S. 105-445; Section 4 became effective upon ratification, Section 5 becomes effective January 1, 1995, and Section 6 becomes effective January 1, 1999.

Section 12 of the act deletes a cross-reference to repealed G.S. 105-436 that appeared in the statute that imposes a motor fuel inspection fee of 1/4¢ a gallon. It also inserts a reference to the statutes that impose a tax on special fuel as opposed to gasoline. Section 13 inserts the missing word "a" in the definition of "reseller" in G.S. 105-449.2(8).

The provisions of this act, other than Sections 13, 14, and 15, were recommended by the Revenue Laws Study Committee.

1992 Chapter 914 (Senate Bill 1015, Sen. Winner)

AN ACT TO RELIEVE A SELLER WHO SELLS PROPERTY UNDER A CERTIFICATE OF RESALE OF THE BURDEN OF PROVING THAT THE SALE WAS FOR RESALE AND TO PROVIDE A PENALTY FOR A PURCHASER WHO MISUSES A CERTIFICATE OF RESALE.

This act eliminates the requirement that a seller who sells property under a certificate of resale make a "reasonable and prudent inquiry concerning the type and character of the tangible personal property [sold] as it relates to the principal business of the [buyer]" in order for the seller to escape the statutory presumption that the sale was taxable. All sales of tangible personal property are presumed to be taxable (G.S. 105-164.26). A sale is not taxable if the buyer intends to resell the property. Under former law, a person who sold property in a wholesale sale could negate the presumption that the sale was taxable by checking the buyer's certificate of resale and asking the buyer whether the buyer intended to resell the property. A certificate of resale states that the property bought is for resale, states the buyer's sales tax license number, and indicates the type of property the buyer sells in the regular course of business. If the seller checked the buyer's certificate of resale but did not inquire about the buyer's intended use of the property, the sale was presumed taxable and the seller could be assessed for sales tax on the sale.

This act deletes the requirement that the seller ask the buyer whether the buyer intends to resell the property. In recommending this change, the Revenue Laws Study Committee had found that there were situations in which it would be impossible or impractical for a seller to make an inquiry about the buyer's intended use of the property and keep a record of the buyer's response. Under the new law, the seller does not have the burden of proving that the sale was for resale if the seller, acting in good faith, accepts a certificate of resale from the buyer.

Although this act lessens the burden placed on a seller to ascertain whether or not each sale is for resale, it continues to protect the State's interest in preventing sales tax evasion. If the Department of Revenue proves that the buyer did not resell the property, the seller would remain jointly liable with the buyer for the applicable sales tax. In addition, to deter buyers from evading sales tax by offering a certificate of resale when the property is not going to be resold, the act adds an additional penalty of $250.00 to be assessed by the Secretary of Revenue against a buyer who misuses a certificate of resale. The provisions of this act became effective upon ratification, July 10, 1992.

Recommended by the Revenue Laws Study Committee.

1992 Chapter 917 (Senate Bill 1245, Sen. Odom)

AN ACT TO PROVIDE THAT JOINT AGENCIES CREATED BY INTERLOCAL AGREEMENT TO OPERATE PUBLIC BROADCASTING TELEVISION STATIONS ARE ELIGIBLE FOR SALES TAX REFUNDS PROVIDED TO GOVERNMENTAL ENTITIES.

This act adds a joint agency created by interlocal agreement to operate a public broadcasting television station to the list of governmental entities entitled to an annual refund of both State and local sales and use taxes paid on their direct and indirect purchases of tangible personal property. At this time, the only public broadcasting television station that meets this description is WTVI Channel 42 in Charlotte, North Carolina. In addition to all counties and incorporated cities and towns, there are 15 other, primarily local, governmental entities currently entitled to refunds of State and local sales and use taxes. In addition to this act, Chapter 814 of the 1991 Session Laws added public transportation authorities and regional public transportation authorities to this list of governmental entities entitled to an annual refund of sales and use taxes.

The governmental entities must apply for the refund within six months after the end of each fiscal year. This act became effective upon ratification, July 1, 1992, and applies to sales and use taxes paid on or after July 1, 1992. Thus, the act does not affect the 1992-93 General Fund revenues. It is expected to reduce General Fund revenues in subsequent fiscal years by approximately $33,000 and local government revenues by approximately $17,000 annually.

1992 Chapter 921 (House Bill 1325, Rep. Gamble)

AN ACT TO MAKE CONFORMING CHANGES TO THE CORPORATE INCOME TAX ON UNRELATED BUSINESS INCOME OF EXEMPT CORPORATIONS.

Under both State and federal law, organizations that are exempt from corporate income tax must nevertheless pay tax on "unrelated business income." G.S. 105-130.11(b) is the State law governing corporate income tax on unrelated business income of exempt organizations. When G.S. 105-130.11(a) was amended in 1983 to provide that organizations exempt from federal corporate income tax are also exempt from State corporate income tax, a conforming amendment was not made to expand the scope of G.S. 105-130.11(b) to the same extent. This act makes this conforming change.

Unrelated business income is, with certain exceptions, income from a trade or business the conduct of which is not substantially related to the exercise by the exempt organization of its charitable, educational, or other function that is the basis for its exemption from corporate income tax. The tax on unrelated business income is levied because the organization is engaging

in substantial commercial activities. In the absence of such a tax, nonexempt organizations would be at a competitive disadvantage compared to exempt nonprofit organizations.

When the General Assembly restructured the Corporation Income Tax Act in 1967 to use federal taxable income as a starting point for calculating State taxable income, it retained G.S. 105-130.11(a) rather than adopt the exemptions provided in section 501 of the Internal Revenue Code because there was some question whether adopting the federal language might eliminate exemptions then being enjoyed by some corporations. In 1983, G.S. 105-130.11(a) was brought more closely into conformity with the Code by adding language stating that any corporation that is exempt from federal income tax is also exempt from State income tax. The separate State exemption categories were retained, however, because of continuing questions regarding whether the State exemptions are broader than the federal exemptions.

When the General Assembly amended G.S. 105-130.11(a) in 1983, it failed to make a conforming amendment to G.S. 105-130.11(b). Before the ratification of this act, G.S. 105-130.11(b) made no reference to those organizations exempt under the Code. This act amends G.S. 105-130.11(b) to include all organizations that are exempt from federal corporate income tax but are not specifically listed in G.S. 105-130.11(a).

In amending G.S. 105-130.11(b), the act also eliminates all but one of the exceptions to the definition of unrelated business income that were set out in the State law because they are identical to the federal exceptions that State law has already adopted by reference. The remaining exception under the act, for three types of research, is very similar to the exceptions provided in section 512(b)(7), (8), and (9) of the Code but, because there is some question whether the wording of the State exception might lend itself to a broader interpretation than that given to the Code, the act retains the separate State exceptions for these types of research.

This act is effective for taxable years beginning on or after January 1, 1992. The act has no fiscal effect.

Recommended by the Revenue Laws Study Committee.

1992 Chapter 922 (House Bill 1326, Rep. Gamble)

AN ACT TO UPDATE THE REFERENCE TO THE INTERNAL REVENUE CODE USED TO DETERMINE CERTAIN TAXABLE INCOME AND TAX EXEMPTIONS.

This act rewrites the definition of the Internal Revenue Code used in State tax statutes to change the reference date from January 1, 1991, to January 1, 1992. Updating the reference makes recent amendments to the Internal Revenue Code applicable to the State to the extent that State tax law previously tracked federal law. This update has the greatest effect on State corporate and individual income taxes because these taxes are based on federal taxable income and are therefore closely tied to federal law. The inheritance tax, franchise tax, and intangibles tax also determine some exemptions based on the provisions of the Code.

Since the State corporate income tax was changed to a percentage of federal taxable income in 1967, the reference date to the Internal Revenue Code has been updated periodically. In discussing bills to update the Code reference, the question frequently arises as to why the statutes refer to the Code as it existed on a particular date instead of referring to the Code and any future amendments to it, thereby eliminating the necessity of periodic updates. The answer to the question lies in both a policy decision and a potential legal restraint.

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

Secondly, and more importantly, however, the North Carolina Constitution imposes an obstacle to a statute that automatically adopts any changes in federal tax law. Article V, 2(1) of the Constitution provides in pertinent part that the "power of taxation... shall never be surrendered, suspended, or contracted away." Relying on this constitutional 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."

Each year, in deciding whether the Internal Revenue Code reference should be updated, the General Assembly considers the changes that have been made to the Code in the past year. No changes were made in the Code in 1991 affecting individual income, inheritance, or gift taxes. A few changes were made to the Code in 1991 affecting corporate income taxes. These changes, however, are not expected to have a significant revenue impact on the State's C corporation income tax, S corporation income tax, or franchise tax.

Recommended by the Revenue Laws Study Committee.

1992 Chapter 926 (Senate Bill 811, Sen. Royall)

AN ACT CONCERNING PROPERTY OWNED BY A NONPROFIT EDUCATIONAL INSTITUTION AND USED FOR SPORTS OR RECREATION.

Property owned by nonprofit educational institutions and used exclusively for an educational purpose is exempt from property tax. G.S. 105-278.4 provides that incidental use by the general public of an educational building or facility does not defeat the institution's property tax exemption; the building or facility is still considered to be used exclusively for an educational purpose. This act provides that golf courses, tennis courts, sports arenas, and other similar sport and sport recreational properties owned by nonprofit educational institutions for the use of students and faculty maintain their property tax exemption based on use for an educational purpose, regardless of the extent to which the property is also available to and patronized by the general public.

The county assessor in Durham County considered the general public's use of Duke University's golf course as material, rather than incidental. The assessor denied a property tax exemption for this property based on the incidental use limitation. This act overcomes the incidental use limitation for sports properties of nonprofit educational institutions.

As originally written, the act would have given property owned by private, nonprofit educational institutions the same property tax breaks as property owned by the State educational institutions. Article V, 2(3) of the North Carolina Constitution exempts all property owned by the State and its political subdivisions from property tax. Thus, property owned by State educational institutions is exempt from property tax not by virtue of its use, but by virtue of its relationship to the State. On the other hand, property owned by nonprofit educational institutions and used for an educational purpose is exempt by statute from property tax by

virtue of its use. Under prior law, sports properties owned by nonprofit educational institutions and used to a large extent by the general public were not entitled to a property tax exemption because they were used for a purpose other than the one for which the exemption was granted--an educational purpose.

The act became effective upon ratification, July 1, 1992, and applies to taxes imposed for taxable years beginning on or after July 1, 1992. G.S. 105-282.1 provides that an owner claiming exempt property must file an application for exemption during the listing period. G.S. 105-307 states that the listing period for a fiscal year begins on the first business day in January preceding the fiscal year and continues through the month of January. The revenue effect of this act on local governments is indeterminate.

1992 Chapter 930 House Bill 1324, Rep. Gamble)

AN ACT TO CLARIFY THE STATUTES GOVERNING INCOME TAX RETURNS AND TAX FILING EXTENSIONS AND TO AUTHORIZE THE SECRETARY OF REVENUE TO ALLOW PAPERLESS TAX FILING EXTENSIONS AND ELECTRONIC FILING OF INCOME TAX RETURNS.

This act makes several changes in the laws concerning the filing of certain tax returns. Its principal change is to allow the Secretary of Revenue to provide certain taxpayers with the opportunity to do either or both of the following: (i) file their tax returns electronically and (ii) obtain an extension of time to file their tax returns without filing an application requesting the extension. Under the act, the taxpayers for whom the Secretary can allow electronic filing and paperless extensions are those filing individual income tax returns, estate or trust income tax returns, gift tax returns, and any other returns for which the law does not specifically require the taxpayer to file a paper return or submit an application for an extension.

In addition to this change, the act clarifies that an extension for filing a gift tax return does not extend the time for paying any gift tax due and makes various technical changes to the affected statutes. A large part of the technical changes consists of eliminating unnecessary duplication that exists between statutes that apply to only one tax and statutes in Article 9 of Chapter 105 of the General Statutes; Article 9 contains the administrative provisions that apply to all taxes collected by the Secretary of Revenue.

The act accomplishes its principal change by removing barriers in the former law that prevented the Secretary from implementing an electronic filing program, a paperless extension program, or both. The act, however, does not require the Secretary to implement either of these programs. The act also does not apply to all taxes. Even with the enactment of this act, the Secretary cannot allow corporate income taxpayers, for example, to file their corporate income tax returns electronically or obtain an extension of time for filing their returns without submitting an application for an extension because the act does not change G.S. 105-130.17(d) or (f).

Under the prior law, a taxpayer who filed an individual income tax return or a return for an estate or trust had to "annex" to the return an affirmation that the return was correct. A taxpayer who filed an individual income tax return also had to submit the taxpayer's withholding statement with the return. Sections 3 and 9 of the act modify these requirements by providing that the affirmation and withholding statement must be furnished to the Secretary of Revenue but need not accompany or be attached to the appropriate return. In place of these requirements, the Secretary of Revenue can adopt rules providing that taxpayers who file their individual income tax or estate and trust tax returns electronically must file a separate signature card containing the affirmation and, for individual income tax returns, must include with the signature card a copy of the withholding statement.

Also under prior law, a taxpayer who wanted an extension for filing an individual income tax return or an estate or trust income tax return had to file an application requesting the extension. The Internal Revenue Service is considering implementing a new procedure to simplify the extension process for federal income taxes. If implemented, the federal program would remove the requirement that a taxpayer file an application for an extension. Instead, if the taxpayer has paid the full amount of the federal tax due by the original due date of the return, the taxpayer would be automatically allowed to file the return late without penalty.

Sections 3, 4, 7, 8, 10, and 11 of this act enable the Secretary of Revenue to implement the same extension program for State individual income taxes, estate and trust income taxes, gift taxes, and other taxes for which no contrary State provisions apply by deleting provisions in the current individual income tax laws and estate and trust laws that specifically require a taxpayer to submit an application for an extension of time for filing. In place of submitting an application for an extension of time for filing a return, Section 11 of the act requires a taxpayer to "comply with any application requirement set by the Secretary." The act does not change the law that an extension to file income taxes is not an extension of time for paying the full amount of income tax due.

The act accomplishes the gift tax clarification by the changes made in Sections 10 and 11. Section 10 adds a sentence to G.S. 105-197, the gift tax return statute, to specifically authorize a taxpayer to request an extension of time for filing a gift tax return. Section 11 adds gift taxes to the list of taxes for which an extension of time for filing a return does not extend the time for paying the tax. Prior law was silent on this subject. The Department of Revenue's practice, however, conformed to the clarification made by the act.

Finally, the act makes numerous technical and clarifying changes to the statutes governing income tax returns, information returns, and tax filing extensions. Section 1 rewrites the statute governing income tax returns to clarify who must file, what information the taxpayer may be required to furnish, and when a couple must file a joint return. Section 2 clarifies the law regarding information returns that must be filed by employers and other payers of income and by partnerships. Section 3 clarifies the time and place of filing income tax returns and information returns in addition to deleting the specific requirements that an affirmation be attached to the income tax return and that an application for a filing extension be submitted. Section 4 eliminates redundant language in the income tax law regarding filing extensions; the applicable provisions regarding filing extensions are contained in G.S. 105-263, set out in Section 11 of the act.

Sections 5 and 6 clarify the statutes requiring taxpayers to make returns and requiring the Secretary of Revenue to provide tax filing forms. Sections 7 and 8 revise estate and trust income tax provisions to clarify where returns are to be filed and to delete redundant language regarding tax filing extensions. The applicable provisions regarding filing extensions are contained in G.S. 105-263, set out in Section 11 of the act.

Section 12 repeals a statute relating to joint income tax returns; the provisions of this statute are added to the statute regarding individual income tax returns by Section 1 of the act. Sections 15 through 23 repeal cross-references to the repealed statute.

Section 13 adds a new section to Article 9, the administrative Article of Chapter 105 of the General Statutes. This section clarifies that the provisions of Article 9 apply to all taxes collected by the Secretary of Revenue as well as motor fuel and kerosene inspection fees collected by the Secretary of Revenue. The new section also provides definitions for common terms used throughout Article 9 of Chapter 105 of the General Statutes. Section 14 removes

redundant language in the corporate income tax statutes regarding tax filing extensions; the applicable provisions regarding filing extensions are contained in G.S. 105-263, set out in Section 11. Section 24 makes the act effective upon ratification.

Recommended by the Revenue Laws Study Committee.

1992 Chapter 931 (House Bill 1366, Rep. Redwine)

AN ACT TO EXPAND THE SCHOOL LUNCH SALES TAX EXEMPTION TO INCLUDE ALL SCHOOL FOODS SERVED BY SCHOOL CAFETERIAS DURING THE SCHOOL DAY AND FOODS SOLD BY SCHOOL CAFETERIAS TO DAY CARE CENTERS.

Effective August 1, 1991, this act expands the State and local sales and use tax exemption for school lunches and adds a new exemption for food sold by public school cafeterias to certain day care centers. This act is expected to reduce General Fund revenues by approximately $100,000 annually and local government revenues by approximately $50,000 annually.

The sales and use tax law has provided an exemption for nonprofit sales of lunches to school children within school buildings for more than 35 years. The Department of Revenue construed this exemption to apply to all food, not just lunches, reasoning that when it was first enacted, schools served only lunches, not the breakfasts and nutritional snacks that are also served today. Section 1 of this act clarifies that the exemption applies to all nonprofit sales of food during the regular school day, not just to lunches. Section 1 also clarifies that the school food exemption applies to sales by both private and public school cafeterias.

In addition to making clarifying changes, Section 1 expands this exemption by removing the limitation of its scope to only sales "to school children." As interpreted by the Department of Revenue, the exemption had been allowed for sales to instructional personnel supervising children in the cafeteria but not to other school employees, volunteers, or visitors. Section 1 provides that the exemption now applies to food sold by the cafeteria to anyone within the school building.

The schools included within the exemption addressed in Section 1 of this act are the elementary and secondary schools offering instruction in grades K through 12. A different sales tax exemption, G.S. 105-164.13(27), applies to food sold in dining rooms of institutions of higher learning.

Section 2 of this act creates a new sales tax exemption for food sold by a public school cafeteria to certain child day care centers. To be exempt, the food must be sold to a child day care center that participates in the Child and Adult Care Food Program operated by the Department of Public Instruction. Day care centers operating under this program must be nonprofit centers and must be federally subsidized. As of June 1992, the following school systems sold food to day care centers operating under this program: Alamance County, Burlington City, Alexander County, Beaufort County, Washington City, Cleveland County, Henderson County, High Point City, Nash County, Orange County, Chapel Hill-Carrboro City, and Pitt County.

1992 Chapter 935 (Senate Bill 969, Sen. Carpenter)

AN ACT TO EXEMPT FROM SALES AND USE TAXES FOOD THAT IS ACQUIRED AT WHOLESALE AND THEN DONATED TO A NONPROFIT ORGANIZATION, AND TO REMOVE

THE INSURANCE LIABILITY EXCEPTION TO THE QUALIFIED IMMUNITY OF DONORS AND DONEES OF DONATED FOOD.

This act creates a new sales and use tax exemption for certain food donated for charitable purposes and provides that the existing qualified immunity for donors and donees of food applies regardless whether the donor or donee has liability insurance. The act became effective August 1, 1992.

Section 1 of this act exempts from State and local sales and use taxes food that is purchased by a wholesale merchant or a retailer for resale and, instead of being resold, is then donated to a nonprofit organization to be used for a charitable purpose. Under prior law, a wholesale merchant (including a manufacturer) or a retailer who manufactured or bought food for resale and then gave the food to a food bank or other nonprofit organization instead of selling the food was liable for use tax on the food or the food ingredients. A wholesale merchant or retailer does not pay sales or use taxes when buying food or the ingredients to manufacture food because the food is to be resold and sales and use taxes do not apply to property purchased for resale or ingredients purchased to manufacture products for resale. If it turned out that the wholesale merchant or retailer did not resell the food, under prior law, the wholesale merchant or retailer became liable for use tax on the food or food ingredients because the resale exemption no longer applied. Section 1 eliminates this liability for use tax by providing a specific exemption for food donated by a wholesale merchant or retailer to a nonprofit organization to be used for charitable purposes. Section 1 of this act is expected to reduce General Fund revenues by $200,000 annually and local government revenues by $100,000 annually.

Under G.S. 99B-10, a person who donates food to a nonprofit organization is not liable for civil damages or criminal penalties resulting from the donated food unless the donor's gross negligence, recklessness, or intentional misconduct caused an injury. Similarly, a nonprofit organization that uses or distributes food donated to it is not liable for civil damages or criminal penalties resulting from the donated food unless the organization's gross negligence, recklessness, or intentional misconduct caused an injury. The statute formerly provided an exception to this qualified immunity: if the donor or nonprofit organization had liability insurance, the donor or organization could be liable for damages, based on negligence, to the extent of the coverage of the insurance. Section 2 of this act eliminates the exception so that the qualified immunity for donors and nonprofit organizations now applies regardless whether the donor or organization has liability insurance.

1992 Chapter 940 (Senate Bill 1195, Senator Daniel)

AN ACT TO EXEMPT FROM SALES AND USE TAXES DRUGS THAT ARE DONATED TO A NONPROFIT ORGANIZATION.

Effective August 1, 1992, this act exempts from State and local sales and use taxes prescription and nonprescription drugs that are donated to a nonprofit organization for a charitable purpose. Under prior law, prescription drugs were exempt from sales tax when sold at retail but not when donated. Nonprescription drugs remain subject to sales tax when sold at retail. This act is expected to reduce General Fund revenues by approximately $100,000 annually and local government revenues by approximately $50,000 annually.

Property purchased for resale and ingredients purchased to manufacture property for resale are not subject to sales and use tax. If the retailer, wholesaler, or manufacturer decides not to resell the property but instead donates it or puts it to another use, the exemption for

property to be resold no longer applies. Until this act added a specific exemption for drugs donated to a nonprofit organization for a charitable purpose, retailers, wholesalers, and manufacturers who made these donations were liable for use tax. Retailers and wholesalers were liable for the amount of sales tax that should have been collected on their purchase of the drugs and manufacturers were liable for the amount of sales tax that should have been collected on their purchase of the ingredients used to manufacture the drugs.

1992 Chapter 949 (Senate Bill 1012, Sen. Winner)

AN ACT TO REINSTATE TWO SALES TAX PROVISIONS THAT WERE INADVERTENTLY DELETED IN PRIOR LEGISLATION AND TO PROVIDE THAT COMPUTER ACCESS CHARGES ARE NOT TANGIBLE PERSONAL PROPERTY.

This act reinstates two unrelated sales tax provisions that were unintentionally deleted in prior legislation. The first provision concerns sales tax on items that are traded in or are repossessed. The second provision concerns the liability of a person who buys a business for sales taxes owed by the seller of the business. This act also codifies a Department of Revenue interpretation of the term "tangible personal property" for sales tax purposes.

Section 1 restores a pre-1989 condition on the sales tax exemption in G.S. 105-164.13(16) for property that has been traded in for another item or has been repossessed. Before 1989, property that had been traded in for another item was exempt from sales tax when it was resold only if sales tax had been collected on the sale of the item for which the property was traded in. Similarly, the sale of a repossessed item would be exempt from sales tax only if sales tax had been paid on the original purchase of the item. This condition was inadvertently deleted by Chapter 692 of the 1989 Session Laws, the Highway Trust Fund legislation, which rewrote the exemption to remove motor vehicles.

Since October 1, 1989, the effective date of Chapter 692 of the 1989 Session Laws, G.S. 105-164.13(16) has exempted traded-in property from sales tax regardless of whether sales tax was paid on the item for which the property was traded in. Likewise, it has exempted the sale of repossessed items from sales tax regardless of whether sales tax was paid on the original sale of the item. To reverse this unintended result, Section 1 of this act puts back into the law the deleted conditions on the exemption.

The act also restores a provision that was inadvertently deleted by Chapter 690 of the 1991 Session Laws. Among other changes, that act rewrote G.S. 105-164.38 to provide an additional one-year period during which the Department of Revenue may assess unpaid sales taxes owed by a retail business against a person to whom the business was transferred. That statute requires the buyer of a business to withhold from the amount paid the seller the amount of any sales taxes the seller owes. If the buyer fails to withhold the required amount, the buyer is personally liable for the seller's taxes.

Before the enactment of Chapter 690, G.S. 105-164.38 allowed the State to assess against the buyer of the business the greater of the amount paid for the business or the fair market value of the business. As amended by Chapter 690, however, the statute limited the amount that can be assessed to the amount paid for the business. Section 2 corrects this error by amending G.S. 105-164.38 to allow the State to assess the buyer of a retail business for the fair market value of the business. This addition is important in cases in which a business is sold at a price that is less than its fair market value.

Section 3 of the act clarifies that the term "tangible personal property" does not include access to a computer program or a database when the user of the computer program or database pays a separately stated fee or other charge for the access. The Department of Revenue has always interpreted the term in this manner for sales tax purposes. This act simply codifies and reiterates an existing departmental practice.

Section 1 of this act became effective August 1, 1992. The remainder of the act became effective upon ratification, July 14, 1992. The act will have a slightly positive effect on the General Fund.

Sections 1 and 2 of this act were recommended by the Revenue Laws Study Committee.

1992 Chapter 950 (Senate Bill 1248, Sen. Odom)

AN ACT TO MAKE THE STATE THRESHOLD FOR IMPOSITION OF A PENALTY FOR UNDERPAYMENT OF INDIVIDUAL INCOME TAXES THE SAME AS THE FEDERAL THRESHOLD.

As its title indicates, this act makes the State threshold for imposition of a penalty for the underpayment of estimated individual income tax the same as the federal threshold. The change is effective for taxable years beginning on or after January 1, 1992. The change is not expected to have a significant impact on General Fund revenues.

The act accomplishes this change by deleting a specified dollar threshold from the State statute and referring to the threshold set in the federal Internal Revenue Code. By using the reference to the Code, the act ensures that the State and federal thresholds will remain the same as long as the General Assembly regularly updates the Code reference date.

The immediate effect of the act is to increase from $40 to $500 the amount of an underpayment of estimated individual income tax that triggers the imposition of the penalty for an underpayment of the tax. The current federal threshold is $500 and the State threshold before this act was $40.

The penalty for an underpayment of estimated individual income taxes is an amount that equals the interest the State lost by an individual's failure to make the required tax payment. Interest is computed at the statutory rate, which is currently 8% a year, from the date the payment should have been made.

The penalty applies to any failure to make required, estimated individual income tax payments. Individuals who receive taxable income from which no taxes are withheld must make estimated tax payments. For individuals who receive wages from which taxes are withheld, the withheld amounts are considered estimated payments of tax.

The $40 State threshold was established in 1973. Before 1973, the federal threshold was $40. For the 1973 tax year and subsequent years, the federal threshold was increased to $100. The federal threshold was again increased by $100 each year in 1982, 1983, 1984, and 1985 to reach the current $500 level. Based on this history, it is possible that the State's original $40 threshold was intended to be the same as the federal and that this act conforms the State threshold with its original intent.

1992 Chapter 955 (Senate Bill 1009, Sen. Winner)

AN ACT MAKING TECHNICAL AND ADMINISTRATIVE CHANGES TO THE LICENSE AND EXCISE TAX LAWS.

This act makes a number of technical and administrative changes to the license and excise tax statutes; the changes became effective upon ratification of the act, July 15, 1992.

Section 1 of the act changes the designation of the lowest bracket of the closed container soft drink dispenser tax from "5-50 dispensers" to "1-50 dispensers" to make it clear that the tax applies to all dispensers of an operator and not just the number above the first four. To be an operator of closed container soft drink dispensing machines for purposes of the tax, a person must have at least five dispensers. The operator must pay an annual privilege license tax of $100 plus an extra amount based on the number of dispensers the operator has. Despite the lowest bracket designation in the table in G.S. 105-65.1(b), the extra amount an operator pays for each dispenser has been construed to include every dispenser of the operator, not just the number above the first four.

Section 2 clarifies that the laundry privilege license tax imposed by G.S. 105-85 applies to a person who provides washing machines and dryers in an apartment building unless that person is the owner or manager of the apartment building. Chapter 479 of the 1991 Session Laws revised the laundry privilege license tax to set two uniform tax rates, one applicable to laundries that do not have vehicles that drive around and pick up laundry and one applicable to laundries that have vehicles that drive around and pick up laundry. In making the changes, a former limitation of the apartment building exemption to the owner or manager of the apartment building was inadvertently omitted. This section reinserts that limitation and brings the statute into conformity with its continued administrative interpretation.

Sections 3 through 12 of this act change the tobacco products excise taxes primarily to make certain provisions that apply to cigarette distributors and to collection of the cigarette excise tax also apply to wholesale and retail dealers of other tobacco products and to collection of the excise tax on other tobacco products. These sections also make technical changes.

Article 2A of Chapter 105 of the General Statutes contains the excise tax on cigarettes and the excise tax on tobacco products other than cigarettes. Section 3 of this act revises general provisions about issuing a license to distribute cigarettes and moves the provisions from Part 2 of Article 2A to Part 1 of Article 2A so that they apply to licenses issued to wholesale and retail dealers of tobacco products other than cigarettes as well as licenses issued to distributors of cigarettes. These provisions require licenses to be issued by the Secretary of Revenue, require payment of the license tax before a license is issued, require a license to be posted at the appropriate place of business, specify that a refund of a license tax is allowed only when the tax was collected or paid in error, and specify the procedure for obtaining a duplicate or amended license.

Sections 4 and 11 change the word "fee" in two sections of Article 2A to "tax" to make consistent the language used throughout Article 2A to refer to the payment for a license. Sections 5, 6, and 8 delete the license provisions from Part 2 of Article 2A that were moved by Section 3 to Part 1 and reformat the remaining provisions in the affected sections of Part 2. The reformatting makes the provisions more readable; it does not make substantive changes.

Sections 7 and 9 delete incorrect cross-references in the tobacco tax statutes. Section 7 deletes an incorrect reference in G.S. 105-113.16(e) to G.S. 105-84, which was repealed by Chapter 150 of the 1979 Session Laws and replaced by G.S. 105-102.5(b)(7). Section 9 deletes an incorrect cross-reference in G.S. 105-113.24(b) to G.S. 105-113.13(d), which is reformatted by Section 5 of this act as G.S. 105-113.13(b).

Section 10 extends a provision that applies to manufacturers of cigarettes to manufacturers of tobacco products other than cigarettes. Section 10 allows manufacturers of tobacco products other than cigarettes to apply to the Secretary of Revenue for permission to be exempt from paying the excise tax on sales to wholesale and retail dealers, the result being that the tax would be paid by the wholesale or retail dealer.

Section 12 deletes an unnecessary refund provision that had created confusion among some taxpayers and was contrary to the designated sale procedure in G.S. 105-113.37, which is intended to be the mechanism for avoiding payment of the tobacco products excise tax on the sale of products to which the tax does not apply. Some taxpayers had argued that the designated sale procedure was optional and that the taxpayer could simply file for a refund as provided in G.S. 105-113.37(c) rather than follow the designated sale procedure. That subsection, however, was intended merely as a cross-reference to the general refund provisions in Article 9 of Chapter 105 and not as a substitute for the designated sale procedure. Repeal of the subsection does not change the general law in Article 9, but removes the appearance in G.S. 105-113.37 that the designated sale procedure is optional.

Sections 13 through 16 amend the soft drink excise tax statutes, which were extensively revised by Chapter 689 of the 1991 Session Laws. Section 13 slightly expands the definition of "natural" to allow a beverage to be considered natural even if it has added minerals, such as iron or calcium, or added extracted ingredients, such as essence. As amended in 1991, the law provided that beverages with added ingredients other than vitamins were not considered natural. Section 14 corrects a grammatical error. Section 15 rewrites the exemption for certain base products for domestic use to make it more understandable but to make no substantive change. Section 16 deletes a refund provision in the soft drink excise tax statutes that is similar to the provision in the tobacco excise tax statutes repealed by Section 12 of this act. The soft drink refund provision is deleted for the same reasons as the tobacco tax provision.

Sections 18 and 19 of this act revise the laws authorizing counties and municipalities to tax laundries, dry cleaners, and similar businesses. Under prior law, municipalities could tax these businesses located within their borders, and both counties and municipalities could tax businesses that were located out of State but sent trucks within the county's or municipality's borders. Sections 18 and 19 delete the authority of both counties and municipalities to tax laundries, dry cleaners, and similar businesses located out of State. The prior law created a possible constitutional violation because it taxed out-of-State businesses more heavily than in-State businesses. Under the prior law, a North Carolina laundry or dry cleaner that sent trucks into more than one county or municipality could be taxed only by a municipality in which it was located. A Virginia laundry or dry cleaner that sent trucks into more than one North Carolina county or municipality could, however, be taxed by every county and municipality into which it sent trucks. As amended by this act, the law no longer discriminates against out-of-State businesses because it does not allow local governments to tax out-of-State laundries, dry cleaners, or similar businesses.

The provisions of this act, other than Sections 18 and 19, were recommended by the Revenue Laws Study Committee.

1992 Chapter 961 (House Bill 1350, Rep. Kerr)

AN ACT TO MAKE TECHNICAL AND ADMINISTRATIVE CHANGES RELATING TO PROPERTY TAXES ON MOTOR VEHICLES.

This act makes technical and administrative improvements to the new procedure for collecting property taxes on motor vehicles that was enacted by Chapter 624 of the 1991 Session Laws and first becomes effective January 1, 1993. The improvements were recommended by the groups that worked to develop the new procedure: the North Carolina Association of County Commissioners, the North Carolina League of Municipalities, the Division of Motor Vehicles (DMV), the North Carolina County Assessors' Association, the Department of Revenue, and the Institute of Government.

The improvements made by this act become effective January 1, 1993. They are explained in the section by section analysis below. They do not change the basic structure of the new procedure as enacted by Chapter 624 of the 1991 Session Laws.

Under the new procedure, all motor vehicles other than the few that are exempted from the procedure are classified for listing, assessment, and taxation separately from other classes of property. Those classified vehicles that are registered with DMV will be taxed on a revolving, year-round schedule. Those classified vehicles that are not registered with DMV will continue to be listed, assessed, and taxed in accordance with the system now in effect.

Every month under the new procedure, DMV will provide each county a list of the motor vehicles in the county for which registration was renewed or obtained two months earlier. The county will then list and appraise the vehicles and send the vehicle owners a bill for the county, city, and special district taxes due. If the owner does not pay the taxes due on a classified, registered vehicle, DMV will refuse to renew the vehicle registration the following year unless the owner obtains a receipt showing that the taxes have been paid.

Chapter 624 of the 1991 Session Laws was enacted to improve the collection rate for property taxes on motor vehicles. It was estimated that $11.1 million in property tax revenue is lost each year because of noncompliance with the requirement to list motor vehicles for property taxes. By tying the listing of most motor vehicles to the registration of the vehicles, the 1991 act eliminates most of the opportunity for noncompliance.

Section	Explanation
1	Includes passenger and service vehicles owned by a public service company within the definition of "rolling stock" so that the vehicles will be appraised by the Department of Revenue and will be exempt from the new procedure. Chapter 624 exempted rolling stock of a public service company from the new procedure because it is appraised by the Department of Revenue rather than by a local tax office and its property tax values are assigned by the Department of Revenue to local governments. By including passenger and service vehicles in the definition of "rolling stock," this section makes uniform the property tax treatment of vehicles owned by public service companies.
2	Repeals a statute that incorrectly exempts all classified motor vehicles from the current system of property tax. Under the new procedure, a classified vehicle that is not registered with DMV will continue to be taxed under the system now in effect. Payment of tax under the new procedure is triggered by the registration of the vehicle with DMV. If a vehicle is not registered, it should nevertheless be subject to tax and it should be taxed under the system now in effect.

3 Exempts the following vehicles from the new procedure:

a. Vehicles that are not required to be registered with DMV under G.S. 20-51. These vehicles include farm tractors, farm trailers, and mopeds. Vehicles that are not registered with DMV never trigger payment under the new procedure and, therefore, should not be subject to the new procedure.

b. Mobile classrooms. Although subject to registration, most mobile classrooms are not registered and would, therefore, not trigger payment under the new procedure.

c. Mobile offices. Although subject to registration, most mobile offices are not registered and would, therefore, not trigger payment under the new procedure.

d. Semitrailers registered on a multiyear basis under G.S. 20-88. These vehicles are not registered annually and would, therefore, not trigger payment under the new procedure.

4 Makes two changes:

a. Changes the valuation date for a new vehicle that is subject to the new procedure but whose value cannot be determined as of January 1 of a year from the first day of the month in which the vehicle is registered to the date that model vehicle was first offered for sale in the State.

b. Requires an appeal concerning a vehicle that is subject to the new procedure to be filed with the assessor within 30 days after the owner is notified of the tax due.

5 Sets May 1 of each year as the due date for payment of taxes under the new procedure on classified motor vehicles that are on an annual, as opposed to a staggered, registration system with DMV. Most motor vehicles are registered under the staggered system, which provides for vehicle registrations to expire during different months of the year so that all registrations do not have to be renewed at the same time. Commercial vehicles and some private passenger vehicles, however, are registered under an annual system; their registrations are due to be renewed each year between December 1 and the following February 15.

6 Specifies the information that must be on the tax notice sent to a classified, registered vehicle owner and reverses the order of subsections (b) and (c) of the affected statute.

7 Makes two changes concerning the release or refund of taxes under the new procedure:

a. Clarifies that for the owner of a classified, registered vehicle to obtain a release or refund of taxes when the owner surrenders the vehicle's license plate to DMV, the owner must have transferred the vehicle to a new owner.

b. Gives these owners 60 days after surrendering the plates to apply for a release or refund of the taxes.

8 Clarifies that monthly lists of vehicles prepared by the county tax collector should include only classified, registered vehicles.

9 Authorizes the board of commissioners of each county to appoint a special committee to hear appeals concerning classified, registered motor vehicles.

10 Clarifies that the tax collector's relief from collecting taxes on classified motor vehicles applies only to classified vehicles that are registered.

11 Specifies when DMV is to send each county assessor a list of vehicles registered under the annual, as opposed to the staggered, registration system. The list is to be sent in March and is to include all the annual registrations made between the annual registration period of December 1 through February 15.

12 Amends the effective date of Chapter 624 of the 1991 Session Laws to provide for vehicles registered under the annual, as opposed to the staggered, registration system. The new procedure will apply to annual-system vehicles renewed in the period beginning December 1, 1992. For the 1993 tax year, taxes on annual-system vehicles will be due July 1; for subsequent years the taxes will be due May 1.

13 Makes the act effective January 1, 1993, the same date as Chapter 624 of the 1991 Session Laws.

Recommended by the Revenue Laws Study Committee.

1992 Chapter 965 (Senate Bill 1016, Sen. Winner)

AN ACT TO REPEAL THE PRIVILEGE LICENSE TAX ON SECURITY DEALERS, TO INCREASE THE REGISTRATION FEE FOR SECURITY SALESMEN, AND TO MAKE TECHNICAL CHANGES.

This act repeals the current privilege license tax on companies that deal in securities and increases the annual registration fee for individuals that sell securities from $45 to $55. The fee is payable to the Secretary of State under G.S. 78A-37 when the annual registration is renewed. The registration expires on March 31 of each year. The purpose of the act is to remove the inequities in the former privilege license tax on securities dealers by converting the tax from a per office tax to an increase in a fee that applies to the number of individuals who sell securities. The act also makes technical changes in the privilege license tax on those who deal in installment paper to make it clear that the tax on installment paper dealers applies to certain secured transactions and not to securities.

The privilege license tax on security dealers taxed the entity that was registered as a securities dealer with the Secretary of State under G.S. 78A-2. The entity could be an individual, a partnership, or a corporation. The tax on a securities dealer was either $200 or $450 for each office location of the dealer--$200 for a location that did not have a wire service that provided stock price quotes and $450 for each location that had a wire service that provided stock price quotes.

A significant inequity resulted from the imposition of the tax on the basis of the number of office locations rather than on the volume of business or number of agents. A dealer, for example, who had one agent in five offices located throughout the State paid five times as much tax as a dealer who had one office but had 25 agents working in that office. Insurance companies, in particular, were affected by this inequity because they frequently have agents in offices throughout the State and many agents are authorized to sell mutual funds, which are

a type of security. The insurance company was therefore liable for the securities dealer privilege license tax based on each office that has an agent who sells mutual funds.

The repeal of the privilege license tax on securities dealers and the technical changes became effective upon ratification, July 15, 1992. The increase in the registration fee on securities salesmen becomes effective January 1, 1993. The General Fund is expected to gain $30,000 in fiscal year 1992-93 and $90,000 each fiscal year thereafter from this act.

1992 Chapter 974 (House Bill 1455, Rep. Brubaker)

AN ACT TO IMPOSE A PRIVILEGE LICENSE TAX ON REAL ESTATE APPRAISERS.

This act adds real estate appraisers to the list of professionals subject to an annual privilege license tax of $50 under G.S. 105-41(a). Real estate brokers and salesmen are subject to this privilege license tax. Thus, the act treats real estate appraisers the same as other individuals licensed in the real estate field. The law provides that an individual who is licensed under the real estate license law as a real estate broker or salesman and as a real estate appraiser need only obtain one privilege license to cover both activities.

The act also substantially rewrites G.S. 105-41(a) to make it easier to read and understand. The act became effective July 1, 1992. Its impact upon the General Fund is expected to be negligible.

1992 Chapter 975 (Senate Bill 1003, Sen. Block)

AN ACT TO PROVIDE THAT CONTRACTORS' INVENTORIES WILL BE ENTITLED TO THE SAME PROPERTY TAX EXEMPTION AS MANUFACTURERS', RETAILERS', AND WHOLESALERS' INVENTORIES.

This act is one of two enacted in 1992 that expand the property tax exemption for inventories. In 1985 and 1987, the General Assembly enacted legislation exempting from property tax inventories owned by manufacturers and retail and wholesale merchants. Inventories were defined as goods held for sale in the regular course of business by manufacturers and retail and wholesale merchants. The term included property consumed in the process of manufacturing goods for sale. The State reimburses local governments annually for part of their loss due to elimination of this part of their property tax base.

Effective beginning with the 1992-93 tax year, this act provides that contractors' inventories will also be exempt from property tax. A contractor is defined as someone in the business of building, installing, repairing, or improving real property. The act also expands the definition of inventories so it now includes not only goods held for sale by contractors but also goods held by contractors to be furnished in the course of building, installing, repairing, or improving real property. The act does not provide a State reimbursement to local governments for their revenue losses due to this elimination of part of their property tax base. The amount of local government revenue loss that will result from the act is not known. The Association of General Contractors had estimated that the total amount of property taxes that could be levied on contractors' inventories was between $2 and $4 million annually.

1992 Chapter 977 (Senate Bill 67, Sen. Block)

AN ACT TO PROVIDE A TAX CREDIT FOR THE USE OF NORTH CAROLINA PORTS.

This act provides a State income tax credit to any corporation or individual using the Wilmington or Morehead City ports for the export of cargo. Although the North Carolina ports have the capacity to accommodate additional vessels and cargo, 70% of North Carolina exporters and importers use ports in other states to move their cargo. To increase the use of the State's ports, the number of shipping lines and cargo sources available through the ports needs to increase. It is hoped that the tax credit will increase the volume of cargo moving through the State ports and thereby attract the shipping lines necessary to move that cargo.

The income tax credit provided by the act equals the excess of charges paid, directly or indirectly, on exported, processed cargo for the current taxable year over an amount equal to the average of charges paid for the current taxable year and the two preceding taxable years. The credit is limited to 50% of the tax imposed for the current year. Any excess credit, however, may be carried forward and applied to the taxpayer's income tax liability for the next five years. The cumulative credit may not exceed one million dollars per taxpayer.

The credit applies to wharfage, handling charges on break bulk cargo or LCL (less-than-container-load) cargo, bulk through put charges (bulk products wharfage), and the equivalent or like charges on container cargo. To receive a credit, the taxpayer must provide a statement from the State Ports Authority certifying the amount of charges paid on which the credit is based and any other information necessary to verify the amount of credit allowable.

The act also requires the State Ports Authority to make an annual report to the General Assembly on the impact of this act on shipping and economic growth.

The act becomes effective for taxable years beginning on or after March 1, 1992, and ending on or before February 28, 1996. It is estimated that the loss to the General Fund will be $13,000 for the 1992-93 fiscal year and $477,000 for fiscal year 1993-94 from this act.

1992 Chapter 981 (Senate Bill 1007, Sen. Winner)

AN ACT TO PROVIDE THAT IF A PERSON CONDUCTS BUSINESS AT A TRADE SHOW OR FLEA MARKET, THE TRADE SHOW OR FLEA MARKET IS NOT CONSIDERED THE PERSON'S BUSINESS LOCATION FOR THE PURPOSE OF THE PRIVILEGE LICENSE TAX.

Effective July 20, 1992, this act exempts specialty market vendors from any requirement of obtaining a State privilege license and paying the applicable State privilege license tax before offering goods for sale at a specialty market. As defined in G.S. 105-53(d), a "specialty market vendor" is a person who offers goods for sale at a specialty market and does not have a store in the same county as the specialty market, and a "specialty market" is a location, other than a retail store, where space is rented to others for the purpose of selling goods at retail or offering goods for sale at retail. A flea market and a trade show are examples of specialty markets.

Article 2 of Chapter 105 of the General Statutes requires a State privilege license for various types of businesses and imposes a State privilege license tax for each required license. State privilege licenses are location licenses. Therefore, if a person engages in a taxed business, such as the retail sale of motor vehicles or motor vehicle parts and accessories, at more than one location, the person generally must have a separate privilege license and pay the applicable privilege license tax for each location.

Under prior law, a person who sold goods for which a State privilege license was required both at a store located in the State and at one or more trade shows or flea markets held outside the county in which the store was located had to have one State privilege license for the store and another for each trade show or flea market. Similarly, if a person who did not have a store in this State participated in one or more trade shows or flea markets in this State and sold goods for which a State privilege license was required, the person had to obtain a State privilege license for each trade show or flea market.

This act eliminates the requirement that a person obtain any applicable State privilege license before selling goods at a trade show or flea market. Thus, an automobile parts dealer required to obtain a State privilege license under G.S. 105-89 will no longer have to obtain another State privilege license to sell automobile parts at a trade show or flea market. Similarly, a merchant who sells pianos, bicycles, home appliances, or electronic equipment for which a State privilege license is required under G.S. 105-102.5 will no longer have to obtain another State privilege license to sell these items at a trade show or flea market. Because fewer State privilege license taxes will be paid as a result of this act, the act is expected to result in a revenue loss to the General Fund of no more than $50,000 in fiscal year 1992-93 and each subsequent year.

1992 Chapter 993 (House Bill 916, Rep. Barnes)

AN ACT TO PROVIDE THAT REIMBURSEMENT TO LOCAL GOVERNMENTS SHALL BE PROVIDED BY EARMARKING RATHER THAN BY APPROPRIATION AND TO PROVIDE THAT THE FISCAL TRENDS STUDY COMMISSION SHALL STUDY LOCAL GOVERNMENT FISCAL ISSUES.

This act changes the source of funds used to reimburse local governmental units for the loss of certain local tax revenue, makes conforming changes required by the change in the source of funds, changes the time when some of the reimbursements must be made, and directs the Joint Select Commission on Fiscal Trends and Reform to refer issues affecting local governments to a subcommittee of that Commission. The act became effective July 1, 1992. The act does not affect the source of funds for appropriations to local governmental units of certain amounts of State taxes, nor does it change the 1991 "freeze" on those reimbursements and State-shared taxes that previously had built-in growth factors.

Sections 1 through 5 and Section 10 of the act change the source of the reimbursement funds from appropriations made to the Reserve for Reimbursements to Local Governments and Shared Tax Revenues to current collections of corporate income tax. This switch to an identified revenue stream as the source of the funds for the reimbursements removes the funds from the Current Operations Appropriations Act, thereby restoring the method for funding the reimbursements that was used before the creation of the Local Government Tax Reimbursement Reserve effective July 1, 1989.

Removal of the funds from the Current Operations Appropriations Act has three principal effects. First, it avoids annual legislative consideration of the amount needed to fund the reimbursements. Second, it eliminates the possibility that the Governor, acting under Article III, 5(3) of the North Carolina Constitution, could reduce the amount distributed from the Reserve to prevent a deficit for a fiscal year. Third, because it takes the reimbursements out of the State's operating budget as contained in the Current Operations Appropriations Act, it removes the amount of the reimbursements from any formula that restricts the growth in the operating budget or otherwise ties an event to an amount in the operating budget.

Section 5 of the act, along with Section 6, also separates the reimbursement for the revision of the intangibles tax on accounts receivable from the intangibles tax-sharing provisions. The act leaves the tax-sharing provisions in G.S. 105-213 and moves the reimbursement provisions to G.S. 105-213.1.

Sections 7 and 8 change the timing of the reimbursements for repealed property taxes on inventories and on poultry, livestock, and feed for poultry and livestock. Prior law stated that the Secretary of Revenue was to make the reimbursements as soon as practicable after January 1 of each year, and the reimbursements were made in March of each year except 1992, when they were made in April because of cash-flow problems. At the request of the State Controller, this act changes the date to April 30 because the State's cash flow is generally at a low in March and improves in April.

Section 9 directs the Joint Select Commission on Fiscal Trends and Reform, created in 1991, to broaden its study of local government fiscal issues and to refer these issues to a subcommittee. The full Commission is to study the report of its subcommittee and make recommendations on these issues to the 1993 General Assembly.

Sections 11 through 14 of the act make conforming changes to various statutes that include the reimbursement funds in the Current Operations Appropriations Act. Because this act changes the source of the funds from an appropriation to an automatic deduction from corporate income tax collections, it also deletes all references to the funds as an appropriation.

The State reimburses local governmental units for the loss of the local tax revenue described below. The State reimburses local units for this lost revenue because the General Assembly's action in removing property from either the local sales and use tax base or the local property tax base is the cause of the lost revenue.

(1) **Revenue lost because of the removal of food purchased with food stamps or supplemental food instruments (WIC vouchers) from the sales and use tax base.**

The exemption, in G.S. 105-164.13(38), became effective October 1, 1985, and the reimbursement, required by G.S. 105-164.44C, began in fiscal year 1986-87. As specified by Section 1 of this act, the Department of Revenue is to make the reimbursement as soon as practicable after July 1 of each year by taking the amount needed from corporate income tax collections. For the 1992-93 fiscal year and each subsequent fiscal year, the Department plans to make the reimbursement in October, which is when counties and cites have previously received this reimbursement.

The Department of Revenue allocates to each county the amount of local sales and use tax revenue determined to be lost in the county during the 1989-90 fiscal year as a result of the exemption. The Department then distributes the allocated amount between the county and the cities in the county in accordance with the method by which local sales and use taxes are distributed in that county under G.S. 105-472. At the direction of the board of county commissioners, local sales and use taxes are distributed between the county and the cites located in the county on the basis of either population or proportional property tax levies. The total amount distributed to all counties and cities each year is $6,409,140.

(2) **Revenue lost because of the removal of money on hand, money on deposit, and funds on deposit with insurance companies from the intangible personal property tax base, and the revision of the intangible personal property tax on accounts receivable.**

The exemptions, in G.S. 105-275(31), and the revision, in G.S. 105-201, became effective for taxable years beginning on or after January 1, 1985, and the reimbursement, now required by G.S. 105-213.1 and, prior to this act, required by G.S. 105-213 and 105-213.1, began in fiscal year 1986-87. As specified by Section 5 of this act, the Secretary of Revenue is to make the reimbursement on or before August 30 of each year by taking the amount needed from corporate income tax collections; August 30 is the same date by which local units receive tax-sharing revenue under G.S. 105-213 based on the amount of intangible tax revenue collected by the State. Prior law stated that the Secretary was to make the reimbursement as soon as practicable after July 1 of each year, and the reimbursement was always made during the last week of August.

The Department of Revenue allocates to each county the amount of revenue allocated to the county in August of 1990 for the lost intangible tax revenue. The 1990 allocation was based on actual collections of tax on the exempted items for the 1984-85 fiscal year, increased each year by a growth factor based on growth in State personal income, plus 40% of actual collections on accounts receivable for the 1989-90 fiscal year. The 1990 total allocation amount for the exempted items was $27,298,512.70, and the 1990 total allocation for the revision of the tax on accounts receivable was $6,342,062.76. Having determined the total amount to be allocated, the Department then distributes the allocated amount between the county and the municipalities, including any special districts, in the county in accordance with proportional property tax levies.

(3) **Revenue lost because of the removal of inventories owned by manufacturers from the personal property tax base.**

The exemption, in G.S. 105-275(33), was phased in over an eight-year period and began in 1980 as a limited income tax credit for part of the amount of property taxes paid on certain manufacturing inventories. The income tax credit was expanded to a 20% credit for all manufacturers effective for the 1986 income tax year and was again expanded to a 40% credit for all manufacturers effective for the 1987 income tax year. The income tax credit was repealed beginning with the 1988 income tax year and all inventories owned by manufacturers were exempted from property taxes beginning with the 1988-89 property tax year. The reimbursement, required by G.S. 105-275.1, began in fiscal year 1988-89; however, the State had indirectly subsidized property taxes on manufacturers' inventories since 1980 when the first income tax credit on manufacturers' inventories became effective. As specified by Sections 2 and 7 of this act, the Secretary of Revenue is to make the reimbursement on or before April 30 of each year by taking the amount needed from corporate income tax collections.

The Secretary of Revenue reimburses counties and cities for the lost property tax revenue in the amount they received for this purpose in March of 1991.

The 1991 allocation for counties was based on inventories listed in the county for the 1987 tax year and adjusted by the initial one-time application of a growth factor based on growth in State personal income. The 1991 allocation for cities was based on (i) inventories listed in the city for the 1987 tax year and adjusted by the initial one-time application of a growth factor based on growth in State personal income plus (ii) inventories that would have been listed in the city for the 1987 tax year if areas annexed between September 1, 1987, and July 1, 1990, had been part of the city in January of 1987, adjusted by the one-time initial application of a growth factor based on growth in State personal income. The 1991 total allocation for the revenue lost by the exemption for manufacturers' inventories was $106,471,222.

(4) **Revenue lost because of the removal of poultry, livestock, and feed used in the production of poultry and livestock from the personal property tax base.**

The exemption, in G.S. 105-275(37), changed over an eight-year period from an income tax credit to the current exemption. An income tax credit for property taxes paid on poultry or livestock by the producer of the poultry or livestock became effective in 1981 and remained unchanged until 1989 when it was repealed and replaced by the current exemption for poultry and livestock and feed used in the production of poultry and livestock. The reimbursement, required by G.S. 105-275.1(b), began in fiscal year 1989-90; however, the State had indirectly subsidized property taxes on poultry and livestock since 1981 when the income tax credit on poultry and livestock became effective. The reimbursement for this lost property tax revenue is required by the same statute that requires a reimbursement for revenue lost because of the repeal of the property tax on manufacturers' inventories. As specified by Sections 2 and 7 of this act, the Secretary of Revenue is to make the reimbursement on or before April 30 of each year by taking the amount needed from corporate income tax collections.

The Secretary of Revenue reimburses counties and cities for the lost property tax revenue in the amount they received for this purpose in March of 1991. The 1991 allocation for both counties and cities was based on poultry, livestock, and feed listed in each county and city for the 1987 tax year and adjusted by the initial one-time application of a growth factor based on growth in State personal income. The 1991 total allocation for revenue lost because of the exemption for poultry, livestock, and feed for poultry and livestock was $1,650,922.

(5) **Revenue lost because of the removal of inventories owned by retail and wholesale merchants from the personal property tax base.**

The exemption, in G.S. 105-275(34), was phased in over a three-year period beginning with the 1986-87 property tax year. These inventories were classified and taxed under former G.S. 105-277(i) at 90% of their assessed value for the 1986-87 tax year, were classified and taxed at 80% of their assessed value for the 1987-88 tax year, and were completely exempted from tax beginning with the 1988-89 tax year. The reimbursement, required by G.S. 105-277A, began in fiscal year 1986-87.

As specified by Sections 3 and 8 of this act, the Secretary of Revenue is to make the reimbursement on or before April 30 of each year by taking the amount needed from corporate income tax collections.

The Secretary of Revenue reimburses counties and cities for the lost property tax revenue in the amount they received for this purpose in March of 1991. The 1991 allocation was based partly on an amount specified in 1989 that increased each year until 1991 by a growth factor based on growth in State personal income (the first per capita distribution in G.S. 105-277A(b)), partly on an amount specified in 1989 that did not increase each year (the second per capita distribution in G.S. 105-277A(c)), partly on inventories listed for the 1987-88 property tax year (the claims-based distribution in G.S. 105-277A(c1), and partly on a "hold-harmless" adjustment (the supplemental distribution in G.S. 105-277A(c2)). The 1991 total allocation for the lost revenue was $82,073,199.

The reimbursement is distributed among the counties and cities in accordance with several formulas. The first per capita distribution is shared by counties and cities on the basis of population, and the second per capita distribution is shared on the basis of proportional property tax levies. The claims-based distribution is made on the basis of inventory listings in each county and city. The supplemental distribution is made on the basis of the difference between other amounts received by each county and city and the amount of inventory taxes levied by each county and city for the 1987-88 property tax year.

(6) **Revenue lost because of the property tax "homestead exemption."**

The "homestead exemption," in G.S. 105-277.1, is an exclusion from property tax of the first $12,000 of the value of a residence owned by an elderly or disabled person whose annual disposable income does not exceed $11,000. As required by G.S. 105-277.1A, the State reimburses counties and cities for one-half of the property tax revenue lost by them in fiscal year 1990-91 because of the exemption. This amount is $7.8 million. As specified by Section 4 of this act, the Secretary of Revenue is to make the reimbursement by taking the amount needed from corporate income tax collections.

1992 Chapter 1004 (Senate Bill 1264, Sen. Royall)

AN ACT TO AMEND THE DEFINITION OF INVENTORIES IN THE MACHINERY ACT TO INCLUDE CERTAIN COMPUTER SOFTWARE.

This act is the second of two enacted in 1992 that expand the property tax exemption for inventories. In 1985 and 1987, the General Assembly enacted legislation exempting from property tax inventories owned by manufacturers and retail and wholesale merchants. Inventories were defined as goods held for sale in the regular course of business by manufacturers and retail and wholesale merchants. The term included property consumed in the process of manufacturing goods for sale. The State reimburses local governments annually for part of their loss due to elimination of this part of their property tax base.

Effective beginning with the 1992-93 tax year, this act expands the definition of inventory for purposes of the tax exemption to include the following three kinds of computer

programs (software) owned or licensed for use by taxpayers who are manufacturers or retail or wholesale merchants:

(1) Programs developed or modified by the taxpayer for the taxpayer's own use.

(2) Programs developed or modified by someone other than the taxpayer to the special order of or to meet the particular needs of the taxpayer.

(3) Programs developed, acquired, or used to develop or enhance programs the taxpayer intends to sell to others.

A computer program is not inventory, however, if the taxpayer treats it as a capital asset for income tax purposes.

This change is inconsistent with the conceptual basis of the definition of "inventories" as goods held for sale and property consumed in manufacturing goods for sale; the new definition now includes items the taxpayer uses in operating its business. To avoid creating this logical inconsistency in the law, the act should have listed these types of computer software as specific exemptions from the property tax rather than adding them to a definition that does not properly apply.

The new law creates potential problems in that it treats similarly situated taxpayers differently and treats similar property differently. For example, a bank that has a financial program developed to its specifications must pay tax on the program, but a retail store that has a financial program developed to its specifications does not pay tax on the program. A manufacturer that uses an automated manufacturing process must pay tax on the equipment used in the process, including the computer that runs the program that controls the process, but does not pay tax on the program itself.

The act does not provide a State reimbursement to local governments for their revenue losses due to this elimination of part of their property tax base. The amount of local government revenue loss that will result from the act is not known.

1992 Chapter 1007 (House Bill 1321, Rep. Gamble)

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

This act made numerous technical and clarifying changes to the revenue laws and related statutes. The following table provides a section-by-section analysis of the changes.

Section	Explanation
1	Amends the new excise tax on producers of newsprint publications, imposed by G.S. 105-102.6, to make the definition of "net tonnage of newsprint consumed" easier to understand and to remove a phrase in subsection (c) that was inadvertently left in the statute because of an error in engrossing an amendment.
2	Makes clear that the 1990 revision of G.S. 105-116, which was made by Chapter 813 of the 1989 Session Laws (Reg. Sess. 1990), did not change the existing authority of certain local governments to impose local taxes on power companies and gas companies.
3	Clarifies that the individual income tax adjustments for state and local income taxes paid apply to taxes of all states.

4 Deletes a reference to the former 3% merchant's discount. The merchant's discount was repealed effective August 1, 1987, by the School Facilities Finance Act of 1987, Chapter 622 of the 1987 Session Laws.

5 Inserts the missing word "be" in the second sentence of the subsection and corrects style.

6 Adds a cross-reference to the rules for apportioning to this State income of holding companies, so that the proper taxable percentage may be calculated under the intangibles tax for shares of stock in holding companies.

7 Deletes an unnecessary word to conform the language used in the statute. However, this part of the statute was rewritten by Chapter 993 of the 1991 Session Laws so this section has no effect.

8 In 1991, certain insurance statutes were rewritten and renumbered. This section changes references to those statutes to reflect the 1991 rewrite.

9 Deletes references to the following repealed intangibles tax statutes: 105-199 (money on deposit); 105-200 (money on hand); and 105-205 (funds on deposit with insurance companies). The remaining reference is to 105-204 (beneficial interest in foreign trusts).

10 Deletes an inaccurate reference and supplies missing references to the laws governed by the penalty provisions of the Revenue Act.

11 Deletes an inaccurate reference and supplies missing references to the laws governed by the compromise provisions of the Revenue Act. Also clarifies the language of the statute.

12 Inserts a word omitted in a recent rewrite.

13 Changes a cross-reference to a recently repealed statute.

14 Deletes the requirement that financial institutions report currency transactions over $10,000. This requirement is similar to and duplicates the federal requirement, resulting in dual reporting. The State-required reports are not utilized by the Department of Revenue or the State Bureau of Investigation to any extent because of a lack of resources. In addition, the Department has access to the information it needs through its tax exchange agreement with the Internal Revenue Service. The Department of Revenue requested this repeal; the State Bureau of Investigation concurs.

15 The 1990 rewrite of the Business Corporation Act expedited the procedure for dissolving a domestic corporation. See Article 14 of Chapter 55 of the General Statutes. The new law eliminated the former requirement of a tax clearance letter from the Department of Revenue. This section conforms the Revenue Act to the Business Corporation Act by repealing the corresponding provision in Chapter 105 of the General Statutes.

16 Corrects a grammatical error; the verb "are" should be the singular "is".

17 Deletes a phrase that appears twice in the statute. Section 16 of Chapter 42 of the 1991 Session Laws rewrote this statute and contained a redlining error so that the phrase "and to inspection fees levied under Chapter 119 of the General Statutes." appears twice.

18	Eliminates a cross-reference to a repealed statute.
19	Eliminates a cross-reference to a repealed statute.
20-21	Correct incorrect diction and punctuation.
22	Changes improper upper case to lower case and corrects incorrect diction and punctuation.
23	Corrects incorrect diction and punctuation.
24	Corrects an incorrect instruction about the statute that was amended; Section 1 of Chapter 267 intended to rewrite all of G.S. 18B-1114.1, not just G.S. 18B-1114.1(a). G.S. 18B-1114.1 concerns winery special event permits.
25	Repeals a temporary provision concerning the marking of fuel storage tanks. The provision has been superseded by G.S. 105-449.17, which became effective January 1, 1992.
26	Inserts a phrase at the request of the Codifier to make it absolutely clear that the portion of G.S. 153A-292 that was not redlined by the 1991 Session Law remains part of the law.
27	Corrects capitalization and punctuation; the phrase "emergency medical service" is not capitalized elsewhere in Chapter 20 or the General Statutes.
28	Makes G.S. 20-14(4) parallel with the other subdivisions and amends the beginning phrase of the statute so it makes sense when applied to subdivision (4); a person who does not have a license because the license was revoked is not a licensee. The inconsistencies in this statute resulted from the combination of two separate amendments made by Section 2 of Chapter 682 and Section 327 of Chapter 689 of the 1991 Session Laws.
29	Inserts the missing word "one", which was inadvertently deleted by a redlining error.
30-31	Delete unnecessary cross-references to the definition of handicapped, delete obsolete references to handicapped identification cards and pavement markings designating handicapped spaces, correct grammatical errors, and apply the defined terms in G.S. 20-4.01.
32	Deletes an unnecessary and incorrect statutory cross-reference and deletes obsolete provisions concerning the transitions to First in Flight Plates that began in 1982. Personalized plates are issued under G.S. 20-79.4, not G.S. 20-81.3.
33	Corrects an incorrect statutory cross-reference and an incorrect reference to the Special Registration Plate Fund. Section 3 of Chapter 672 of the 1991 Session Laws recodified G.S. 20-81.3 as G.S. 20-79.7.
34	Deletes part of a sentence that repeats the first sentence of G.S. 20-127(d) and inserts the missing word "the" in the remainder of the sentence.
35	Repeals a statutory provision that duplicates another provision, G.S. 65-55(c)(2), and erroneously states the amount of the minimum deposit a cemetery operator must make to a cemetery care and maintenance fund.
36	Corrects a cross-reference to the definition of motor fuel in G.S. 105-430 and conforms both cross-references to other definitions to the standard drafting

format. Chapter 441, Section 1, of the 1991 Session Laws rewrote G.S. 105-430 to, among other things, put the definitions in that statute in alphabetical order. As a result of the rearrangement, the definition of motor fuel is in G.S. 105-430(4) instead of 105-430(1). Standard drafting format, however, requires the deletion of the subdivision reference to avoid this type of problem in the future.

37 Corrects an incorrect cross-reference. The Property Tax Commission statutes were recodified by Chapter 110 of the 1991 Session Laws and no longer appear in Chapter 143B.

38 Eliminates references to assessment ratios in the sanitary district statute and eliminates unnecessary descriptions of procedures that are set out in the Machinery Act.

39 Corrects incorrect statutory cross-references in the Burial Commission statutes.

40 Corrects an incorrect cross-reference.

41 Makes the use of "assessed" and "appraised" in Chapter 159 of the General Statutes consistent. Chapter 11 of the 1991 Session Laws repealed obsolete references in the Local Government Bond Act to assessment ratios. This section is a further conforming change.

42 Corrects an incorrect cross-reference.

43 Makes clear that the restriction on the price for which bonds can be sold applies only to general obligation bonds and not to revenue bonds, thereby making this provision consistent with G.S. 159-125(a). G.S. 159-125(a) was changed in 1987 to allow general obligation bonds to be sold for less than their par value but at no less than 98% of the par value. The last sentence of G.S. 159-123(c) was added at the same time and was intended to apply only to general obligation bonds. However, the sentence just says "the bonds" and has raised questions about the section's applicability to revenue bonds.

44 Deletes an unnecessary reference in a sales tax exemption to motor vehicles. Motor vehicles are no longer subject to sales and use tax.

45-47 Corrects erroneous references to "this act" and makes other stylistic changes.

48 Provides that Section 2 of the act is effective retroactively to June 21, 1990, that Section 3 of the act applies retroactively to taxable years beginning on or after January 1, 1989, and that the rest of the act is effective upon ratification, July 21, 1992.

Most of the sections of this act were recommended by the Revenue Laws Study Committee.

1992 Chapter 1016 (Senate Bill 1262, Sen. Daniel)

AN ACT TO MODIFY THE PROCEDURE FOR PROPERTY TAX APPEALS BEFORE THE PROPERTY TAX COMMISSION FROM APPRAISAL AND LISTING DECISIONS, AND TO CHANGE THE AUTHORITY TO APPOINT ONE MEMBER OF THE PROPERTY TAX

COMMISSION FROM THE PRESIDENT OF THE SENATE TO THE PRESIDENT PRO TEMPORE OF THE SENATE.

This act makes two changes in the law concerning the Property Tax Commission, which is the five-member State board of equalization and review that decides administrative appeals by taxpayers concerning their local property taxes. The changes became effective August 1, 1992.

First, Section 1 of the act eliminates a requirement that previously hampered the Property Tax Commission in exercising its authority to delegate to one or more members of the Commission or to one or more employees of the Department of Revenue the power to act as a hearing officer and hear property tax appeals on behalf of the Commission. The requirement eliminated by the act is the prior requirement that the Commission provide, at its own expense, a transcript of any appeal heard by a hearing officer on behalf of the Commission. The cost of providing the transcript effectively prevented the Commission from delegating its authority to hear appeals and has resulted in a large back-log of appeals waiting to be heard by the Commission.

In lieu of the requirement that the Property Tax Commission provide a transcript in every appeal heard by a hearing officer, the act allows a party to an appeal heard by a hearing officer to request that a transcript of the appeal be prepared for submission to the Commission. The party requesting the transcript must pay for it unless the Commission, for good cause, finds that the Commission should pay for it. If a transcript is prepared, the Commission will consider the transcript when it reviews the findings of fact and conclusions of law received from the hearing officer in the appeal.

With the enactment of Section 1 of this act, the Property Tax Commission plans to begin exercising its authority to delegate the power to hear property tax appeals on its behalf. The Commission plans to delegate to one or more members of the Commission the power to hear simple appeals and to have the full Commission, or at least a quorum of the Commission, hear the more difficult appeals. A simple appeal is one that does not involve a significant legal issue, a question concerning the exemption of property from tax, or a large assessment, and, conversely, a more difficult appeal is one that involves one or more of these elements.

Second, Section 2 of the act transfers from the President of the Senate to the President Pro Tempore of the Senate the power to appoint one of the members of the Property Tax Commission. The President of the Senate is the Lieutenant Governor and the President Pro Tempore of the Senate is a senator who is elected to the position of President Pro Tempore by the members of the Senate. The first appointment by the President Pro Tempore will be for a four-year term beginning July 1, 1995. Although effective August 1, 1992, the act does not affect the current term of the member appointed by the President of the Senate, which expires June 30, 1995.

1992 Chapter 1019 (House Bill 1323, Rep. Gamble)

AN ACT TO REPLACE THE AUTHORITY OF COUNTIES TO RETAIN THEIR COSTS IN COLLECTING THE STATE'S SHARE OF THE DEED STAMP TAX WITH THE AUTHORITY TO RETAIN A FIXED PERCENTAGE OF THE REVENUE FROM THAT TAX.

This act makes several changes concerning the collection and remittance of the excise tax imposed by Article 8E of Chapter 105 of the General Statutes on instruments transferring interests in real property. This excise tax, known as the deed stamp tax, is $1.00 on each

$500.00 of the value of the interest in real property that is transferred. The tax is collected locally by county registers of deeds when deeds and other instruments are recorded and is shared by the State and the counties, with the State and the counties each receiving one-half of the tax proceeds.

The act makes several changes concerning this tax. It changes from an indefinite allowance for "costs" to a flat 2% the amount a county may retain when remitting to the State the State's share of the tax; it changes from monthly to quarterly the frequency with which a county must remit to the State the State's share of the tax; and it makes technical changes to the procedures to be followed by the county registers of deeds in accounting for the tax proceeds. The changes are effective for taxes collected on or after July 1, 1992.

The most important of these changes is the change in the amount a county may retain when remitting the State's share of the tax. The act repeals the authority of a county to deduct the county's cost of "collecting and administering" the tax from the total proceeds of the tax before dividing the proceeds in half and sending the State its one-half share. In place of this authority, the act allows a county to deduct and retain 2% of the State's one-half share of the total proceeds of the tax as compensation to the county for the cost of collecting the State's share of the tax and remitting that share to the State.

In making this change, the act makes it clear that the 2% allowance is compensation for the county's incremental cost in collecting and remitting the State's share of the tax rather than compensation for part or all of the county's costs in collecting the county's share of the tax. The incremental cost to a county consists of the cost to fill out a one-page form each quarter with information the county would have gathered anyway, to calculate the State's share of the tax, to write a check to the State Department of Revenue for the State's share, and to send the form and the check to the Department of Revenue.

The change in the amount a county may retain as compensation addresses a problem created by the 1991 revision of the deed stamp tax. Chapter 689 of the 1991 Session Laws changed this tax in three ways effective August 1, 1991. It doubled the tax rate from 50¢ for each $500.00 of value to $1.00 for each $500.00 of value, expanded the tax base by removing the deduction for the value of an assumed lien, and directed each county to remit one-half of the net proceeds of the tax to the State. G.S. 105-228.30(b) defined "net proceeds" as gross tax proceeds less the cost to the county of "collecting and administering the tax," as determined by the county register of deeds.

The registers of deeds interpreted this direction to deduct the cost of collection and administration in various ways and, consequently, kept widely differing percentages of the gross proceeds of the tax as the cost of collection and administration. From August 1, 1991, through June 30, 1992, the percentage of gross proceeds retained varied from 0% to 91%. Seven counties, Ashe, Craven, Davidson, Gates, Pasquotank, Perquimans, and Wake, retained nothing; 33 counties retained no more than 5%; 25 counties retained from 5% to 10%; 15 counties retained from 10% to 20%; and the remaining 20 counties retained more than 20%.

The variance in these percentages reflects the different methods used by the registers of deeds in calculating the costs of collection and administration. The counties that retained nothing reasoned that the county was collecting the tax anyway and that the cost to write a check to the State and complete the one-page form that must be sent to the Department of Revenue with the check was negligible. Some counties used a flat percentage as a guess of what the costs were. Some counties calculated an average cost of all documents recorded at

the register of deeds office and some calculated an average cost of only instruments that are subject to the deed stamp tax.

For a county that previously retained as compensation for its costs more than is allowed by this act, the amount of tax revenue retained by the county will decrease and the amount sent to the State will increase. For this reason, the State is expected to receive more revenue from the deed stamp tax over a 12-month period than it previously received.

In debating the amount a county should be allowed to keep as compensation for the cost of collecting and remitting the State's share of the deed stamp tax, several members of the General Assembly questioned why there was a difference in the time counties must send the State the State's share of the deed stamp tax and the State must send local governments their sales and use tax revenue that has been collected by the State. Former G.S. 105-228.30(b) required counties to send the deed stamp tax to the State on a monthly basis, and G.S. 105-472 requires the State to send local sales and use tax revenue to local governments on a quarterly basis. This act makes these periods the same by changing the period for sending the State the State's share of the deed stamp tax from monthly to quarterly.

Finally, the act conforms the accounting procedure to be followed by the registers of deeds in collecting the deed stamp tax to the requirements of The Local Government Budget and Fiscal Control Act, Article 3 of Chapter 159 of the General Statutes. G.S. 159-32 requires tax revenue to be deposited daily and requires that revenue deposited by an official other than the finance officer be immediately reported to the finance officer. Former G.S. 105-228.30(b) appeared to authorize a register of deeds to report deed stamp tax collections to the finance officer on a monthly rather than a daily basis and to authorize the register of deeds to deposit only the net proceeds of the tax rather than the total amount collected. This act rewrites the first sentence of G.S. 105-228.30(b) to make it clear that G.S. 159-32 applies to deed stamp tax revenue.

Recommended by the Revenue Laws Study Committee.

1992 Chapter 1030 (House Bill 1656, Rep. Kennedy)

AN ACT TO MAKE VARIOUS TECHNICAL AMENDMENTS TO THE GENERAL STATUTES AS RECOMMENDED BY THE GENERAL STATUTES COMMISSION AND TO MAKE TECHNICAL AMENDMENTS TO THE LAW.

This act makes technical changes to the General Statutes. Three changes relate to Chapter 105 of the General Statutes. Section 25 of the act updates a reference to area mental health authorities in the statute that grants sales tax refunds to certain local government entities. The statute's reference to "area mental health, mental retardation, and substance abuse authorities" is updated to reflect the current terminology: "area mental health, developmental disabilities, and substance abuse authorities." Section 26 of the act changes a cross-reference in the agriculture law from a repealed license and excise tax statute to the statute that now applies. Section 30 deletes from the school law a cross-reference to a repealed sales tax statute. These changes all became effective upon ratification of the act, July 24, 1992.

1992 Chapter 1044 (Senate Bill 1205, Rep. Marvin)

AN ACT TO MODIFY THE CAPITAL IMPROVEMENTS APPROPRIATIONS FOR NORTH CAROLINA FOR THE 1992-93 FISCAL YEAR, TO MAKE OTHER CHANGES IN THE BUDGET

OPERATION OF THE STATE, AND TO MAKE TECHNICAL CORRECTIONS NECESSARY TO EFFECT THE BUDGET OPERATION OF THE STATE.

Section 9.5 of this act modifies the amount of the manufacturers' inventory reimbursement to local governments. The manufacturers' inventory reimbursement was originally calculated based on the value of inventories within local governments as of September 1, 1987. The reimbursement was expanded several times; one of these expansions occurred in 1990 when the General Assembly allowed an additional reimbursement based on the value of inventories located as of January 1, 1987, within an area for which a municipality had instituted annexation proceedings and which later became a part of the municipality. Only one municipality, Mount Holly, qualified for this additional reimbursement.

In 1990-91, the first fiscal year the additional reimbursement was to be made, the amount of the additional reimbursement (approximately $200,000) was drawn from the funds that otherwise would have been used to reimburse local governments that year for lost property taxes on manufacturers' inventory. Each local government's share of the total amount to be reimbursed was reduced by 0.19% to generate the funds for the additional reimbursement. The law did not provide how the additional reimbursement would be funded in later fiscal years. In the 1991-92 fiscal year, the amount of the additional reimbursement was drawn from the General Fund; the other local governments' share was not reduced. Effective beginning with the 1992-93 fiscal year, this section provides that the additional reimbursement will be funded each year as it was in 1990-91: each local government's share of the total amount to be reimbursed under the manufacturers' inventory reimbursement will be reduced by 0.19%.

1991

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1991 Chapter 10 (House Bill 24, Rep. Lilley)

AN ACT TO CONSOLIDATE THE LAWS CONCERNING REPORTS BY THE DEPARTMENT OF REVENUE.

This act repeals obsolete reporting requirements of the Department of Revenue, gathers the remaining reporting requirements into a single statute, repeals obsolete provisions concerning the Tax Research Division of the Department of Revenue, and provides that the Secretary of Revenue may charge a fee for a copy of a report or other document. The act became effective upon ratification, March 20, 1991.

Section 1 rewrites G.S. 105-256 to combine its provisions with those of G.S. 105-453, 105-453.1, and 105-456, repealed by Section 3. It restates current law in directing the Department of Revenue to prepare and publish the Statistics of Taxation and the Biennial Tax Expenditure Report and in enabling the Department to obtain information needed for these or other reports from units of State and local government. It clarifies existing law by specifying who is to receive a free copy of any report prepared by the Department and it deletes the requirements that the Department print 2,000 copies of the Statistics of Taxation and include estimates of revenue loss in the Biennial Tax Expenditure Report. The latter requirement applied only if funds were appropriated for that purpose; funds had not been appropriated for that purpose since the provision was enacted. Should funds be appropriated for that purpose at a later time, the appropriations act would specify the purpose of the funds.

Section 2 provides that the Department may charge a fee for a copy of a report or other document. G.S. 12-3.1 grants similar authority to all agencies.

Section 3 repeals G.S. 119-24, G.S. 147-88, and the statutes on the Tax Research Division of the Department of Revenue because these statutes are obsolete or incorrect in several respects and because the relevant portions are transferred to revised G.S. 105-256. The statutes on the Tax Research Division are left over from the days when the Tax Research Division was a separate department of State government. That separate department became a division of the Department of Revenue in the 1971 reorganization of State government.

In repealing G.S. 147-88 and the Tax Research Division statutes, two obsolete reporting requirements are repealed. The requirement in G.S. 147-88 that the Secretary report proposed revisions of the revenue laws to the General Assembly within the first 10 days of each session is repealed. Likewise, the requirement in G.S. 105-455 that the Secretary submit proposed revisions to the revenue laws to the Advisory Budget Commission is repealed. These statutes had not been followed and, with the advent of legislative study committees, were not needed. The Department of Revenue routinely reports its suggestions for changes to the revenue laws to the Revenue Laws Study Committee, the Property Tax Study Committee, or another special purpose study committee.

Recommended by the Revenue Laws Study Committee.

1991 Chapter 11 (House Bill 50, Rep. Rhodes)

AN ACT TO MAKE TECHNICAL CHANGES TO THE PROPERTY TAX STATUTES.

As the title indicates, this act makes several technical changes to the property tax statutes and statutes that refer to property taxes. The act became effective upon ratification, March 20, 1991.

Section 1 deletes an unnecessary and inaccurate parenthetical in G.S. 105-272. The parenthetical attempts to cite the statutes included in Subchapter II of Chapter 105 of the General Statutes, but does not include all the statutes. Even if it were accurate, the parenthetical is not needed.

Sections 2 through 5 of the bill amend statutes in Chapter 159, Local Government Finance, to delete obsolete references to the assessment ratio and to change the word "appraised" to the technically correct word "assessed." With these changes, the statutes correctly reflect the tax value of property and are consistent with the definitions used in the property tax statutes.

Chapter 159 contains several references to the appraised value of property before application of the assessment ratio. For example, bonds subject to the Local Government Bond Act and certain financing agreements related to capital assets may not be adopted or executed if the local government's net debt exceeds 8% of the appraised value of property subject to taxation by the local government unit before the application of any assessment ratio.

References to the appraised value of property before application of an assessment ratio are obsolete and refer to the pre-1974 procedure for taxing property. Before 1974, local governments assessed a percentage of the property's appraised value for taxation. The value of the property on the tax books was known as the "appraised value" and the percentage was known as the "assessment ratio."

Today, local governments do not apply assessment ratios. By law, they must tax the entire value of the property as listed on the tax records. Since 1974, the appraised value has been defined as the property's true value. Assessed value is the value on the tax books. It is the value on the tax books, for example, that the Local Government Commission looks at to compute the 8% debt limitation.

Recommended by the Property Tax Study Commission.

1991 Chapter 30 (House Bill 13, Rep. Lilley)

AN ACT TO ELIMINATE THE FRANCHISE TAX INITIAL RETURN AND TO INCREASE THE MINIMUM FRANCHISE TAX.

Effective for taxable years beginning on or after September 1, 1991, this act makes two changes to the corporate franchise tax. First, it repeals the requirement that a new corporation file an initial franchise tax return within 60 days after it is authorized to do business in this State and pay a tax of $25.00 for the period from the date of beginning business until the end of the first income year. A new corporation is a corporation that files articles of incorporation in this State or, if the corporation has already been formed in another state, applies for authorization to do business in this State.

Second, it increases the minimum annual corporate franchise tax from $25.00 to $35.00. The act increases the annual minimum to offset the revenue loss that would otherwise occur by repealing the initial return requirement. Overall, therefore, the act neither increases nor

decreases franchise tax revenue to the State. The act, however, increases the tax for a corporation liable for only the minimum franchise tax from $25.00 to $35.00.

Corporations pay franchise tax annually based on the value at the end of the tax year of the largest of (i) capital stock plus surplus and undivided profits apportioned to North Carolina, (ii) 55% of the value of real and tangible personal property in North Carolina plus the value of intangibles, or (iii) the net book value of real and tangible personal property in North Carolina. The tax is at the rate of $1.50 for every $1,000 of value, with a minimum tax of $25.00 until September 1, 1991, and a minimum of $35.00 for taxable years beginning on or after that date. Many corporations are not affected by the increase in the minimum tax because their franchise tax liability is at least $35.00.

Prior law required a new corporation to file an initial corporate franchise tax return within 60 days after beginning business in this State and to pay a tax of $25.00 for the period from the date the corporation began doing business until the end of the corporation's first income year. This act deletes this requirement but does not change the requirement that a new corporation and any other corporation that does business in this State file a franchise tax return and pay franchise tax at the end of each of the corporation's tax years.

Under prior law, if a corporation failed to file the initial franchise tax return and pay the $25.00 tax, its charter or certificate of authority was suspended, even if it filed its subsequent annual returns. Thirty percent of corporate suspensions were a result of failing to file this return. The Department of Revenue reported that this situation caused an administrative burden for the Department of Revenue and the Department of Secretary of State and was inconvenient for taxpayers.

The Department of Revenue also reported that its operation would not be hampered by repeal of the initial return requirement because G.S. 55-16-22 requires corporations other than professional corporations to file an initial report with the Secretary of State within 60 days after the end of the month in which they first incorporate or begin doing business. The Department of Revenue can obtain whatever information it needs regarding these corporations from the Secretary of State and can obtain information about professional corporations from the licensing boards that govern the professions.

Recommended by the Revenue Laws Study Committee.

1991 Chapter 34 (Senate Bill 128, Sen. Winner)

AN ACT TO PROVIDE FOR THE SYSTEMATIC REVIEW OF PROPERTY EXEMPTED OR EXCLUDED FROM PROPERTY TAXATION AND TO ALLOW PROPERTY THAT WAS ERRONEOUSLY EXEMPTED OR EXCLUDED TO BE TREATED AS DISCOVERED PROPERTY.

This act corrects an inequity in the law that allowed property that was granted a property tax exemption or exclusion in error to keep the exemption or exclusion indefinitely unless the use or ownership of the property changed and enacts procedures to require an on-going review of exempt or excluded property. The act became effective upon ratification, April 10, 1991.

Section 1 of the act explicitly requires the applicant for an exemption or exclusion to make a complete and accurate statement of the facts that qualify the property for exemption or exclusion. This addition to G.S. 105-282.1(a) will give the assessor more information on which to make a determination and will enable the assessor to make better decisions. In making this change, the section makes needed technical corrections to the statute.

Section 2 requires each assessor to annually review at least one-eighth of the property that has been exempted or excluded from taxation to verify that the property is entitled to the exemption or exclusion. The assessor may require the owner to submit any information needed to verify that the property continues to qualify for the exemption or exclusion. This procedure parallels the procedure for review of property classified for taxation at its use-value. Each assessor must review one-eighth of the use-value property each year to verify its eligibility for the program.

Section 3 moves the definitions in G.S. 105-312(a) to the appropriate statute and corrects the inequity that existed under prior law by allowing the assessor to use the "discovery" procedures that apply to unlisted property for property that has been granted an exemption or exclusion but does not qualify for the exemption or exclusion either because the exemption or exclusion was granted in error or because the property no longer qualifies as a result of a change in use, ownership, or some other circumstance. Under these procedures, the assessor can discover property at any time during the tax year and can recover up to five years' back taxes.

Section 4 repeals G.S. 105-312(a). This subsection is no longer necessary because the relevant definitions have been incorporated into G.S. 105-273, the definition section.

The act addresses a dilemma raised by the Property Tax Commission in an appeal by the Church of the Creator, Inc. in December of 1989. In that case, the assessor decided the Church of the Creator did not qualify for the "property used for religious purposes" exemption because the Church did not appear to be using the property for religious purposes. The Commission held that the assessor did not have the authority to remove a previously granted exemption during the tax year, even if the property was not entitled to receive the exemption in the first place.

The Commission indicated that the assessor could require the Church of the Creator to complete a new application prior to the listing period for the upcoming tax year but, if the new application was denied, the assessor could not require the owner to pay taxes for the previous years in which it did not qualify for the exemption. Under prior law, however, it was not clear whether the assessor could require the Church of the Creator to file a new application, as the Commission indicated. The law required a new application only for one or more of the following reasons, none of which applied to the Church of the Creator:

(1) New or additional property was acquired.

(2) Improvements were added or removed from the property necessitating a change in value.

(3) There was a change in either the use of the property or the qualifications or the eligibility of the owner.

Recommended by the Property Tax Study Commission.

1991 Chapter 42 (Senate Bill 110, Sen. Winner)

AN ACT TO IMPROVE THE ADMINISTRATION OF THE TAXES ON MOTOR FUELS, SPECIAL FUEL, AND MOTOR CARRIERS, AND TO TEMPORARILY RESTORE THE $40,000 CAP ON BONDS THAT MAY BE REQUIRED OF FUEL DISTRIBUTORS AND SUPPLIERS.

This act makes two types of changes to the motor fuel tax laws. First, it makes a temporary change to the bond amount required of distributors and suppliers of fuel to keep the maximum bond at $40,000 until July 1, 1991. Second, it makes numerous unrelated changes

to these laws to make them clearer and easier to administer. To accomplish this purpose, the act resolves current ambiguities and inequities in the law and makes uniform the provisions that apply to distributors of gasoline and suppliers of special fuel, which is primarily diesel fuel.

The 1990 General Assembly changed the maximum amount of the bond required from a distributor of gasoline or a supplier of diesel fuel from $40,000 to two times the distributor's or supplier's expected tax liability, effective January 1, 1991. Many distributors and suppliers who have a history of timely tax payments had difficulty obtaining bonds at the higher amounts. In recognition of the severity of this problem, this act did two things to help a distributor or supplier who could not obtain the bond required under the 1990 legislation:

(1) It allowed the Secretary of Revenue to accept an irrevocable letter of credit in lieu of a bond from a distributor of gasoline or a supplier of diesel fuel.

(2) It established a temporary ceiling of $40,000 for a bond required of a distributor or supplier by postponing the effective date of the change in the required bond from January 1, 1991, until July 1, 1991. Chapter 441 of the 1991 Session Laws, effective June 28, 1991, established a permanent solution to this problem by setting a maximum bond amount of $125,000.

The act makes uniform the provisions that apply to both distributors of gasoline and suppliers of diesel fuel. It clarifies that a corporation or a limited partnership must be authorized to do business in this State to be a distributor or a supplier, requires an individual or a general partnership to designate an agent for service of process, and makes the language concerning a license application and bond of a distributor the same as for a supplier of special fuel. The act adds failure to keep records to the list of actions for which criminal liability attaches and for which a distributor's or supplier's license can be revoked, inserts a requirement of willfulness in failing to file a report or pay tax when due, specifies the amount of notice that must be given before the Secretary cancels a license of a distributor or a supplier, and conforms the language concerning cancellation of a distributor's license to that used for a supplier. The changes in the amount of notice required are made to ensure due process. The act also provides that a supplier is an agent of the State in collecting the special fuel tax. Distributors are declared agents of the State in G.S. 105-444.

The act makes other changes to the motor fuel tax laws to make them clearer and easier to administer. It gives the Secretary of Revenue the discretion to waive the penalty for a late application for a refund of motor fuel or special fuel taxes rather than require an automatic reduction in the amount of the refund equal to the amount of the penalty. The Secretary generally has the power to waive penalties concerning the late payment of taxes.

The act clarifies that a refund is available only for tax paid on fuel used in the previous year. This is the clear intent of the statute but taxpayers have argued that G.S. 105-446 entitles them to a refund of taxes paid for any year. The question arises only when the Department assesses a taxpayer for the excise tax that was not paid but should have been paid on fuel.

The act deletes the requirement that a bulk-user store at least 100 gallons of fuel. Under prior law, it was not clear how a person who stores less than 100 gallons of fuel for the person's use should be treated.

The act clarifies the liability of a supplier and a user-seller for any tax due on fuel sold or used by the supplier to the user-seller. It makes clear that a supplier is liable for taxes due on fuel sold to a user-seller unless the fuel is dispensed into a tank that is marked "For

Nonhighway Use" and that a user-seller is liable for taxes due on fuel that is dispensed into a tank marked "For Nonhighway Use" but is used for a highway purpose.

The act clarifies that a user-seller who uses more fuel than the user-seller reports is presumed to have acquired the extra fuel tax-free for use in a licensed motor vehicle. The prior law stated that the user-seller is presumed to have acquired the extra fuel tax-free but did not go the extra step and presume that the fuel was acquired for a taxable purpose, thereby creating a presumption that the fuel is taxable. Chapter 441 of the 1991 Session Laws, effective January 1, 1992, expands this presumption to cover fuel incorrectly reported as well as fuel that is not reported at all.

The act allows a truck that is cited for not having a registration card or identification marker to continue to operate if payment of the $75 penalty is not in jeopardy. Prior law prohibited further operation of the vehicle until payment of the $75 penalty regardless of whether payment of the penalty was in jeopardy or the circumstances of the vehicle.

The section of the act establishing a temporary ceiling of $40,000 for a bond or letter of credit required of a distributor or supplier was effective retroactively to January 1, 1991, and expired July 1, 1991. The remainder of the act became effective upon ratification, April 22, 1991.

Recommended by the Revenue Laws Study Committee.

1991 Chapter 45 (House Bill 61, Rep. Lilley)

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

This act makes numerous technical and clarifying changes to the revenue laws and related statutes. The Department of Revenue requested many of the changes in the act. The act became effective upon ratification, April 22, 1991.

The act makes some noteworthy changes to the privilege license tax law. Section 1 adds a definitional statute to the privilege license tax statutes. The definitions included in the statute clarify terms currently in use and allow for consistent use of these terms in the future. Section 3 clarifies that those corporations liable for the banking institution privilege license tax are exempt from the installment paper dealer taxes. Section 4 clarifies the long-standing administrative practice that an installment paper dealer is exempt from loan agency license tax only if its activity is limited to that of an installment paper dealer taxed under G.S. 105-83. An installment paper dealer that extends its activity to that of a loan agency is subject to both installment paper dealer and loan agency license taxes.

The act also makes a couple of changes to the income tax statutes. Section 13 clarifies that a married couple filing a joint return must be liable for at least $2.00 of tax in order for each spouse to check off the box on the form indicating whether $1.00 should go to the North Carolina Political Parties Financing Fund. Sections 20 through 22 recodify the statute allowing taxpayers to donate individual income tax refunds to the North Carolina Candidates Financing Fund and combine the corporate income tax provision allowing taxpayers to donate income tax refunds to the Wildlife Fund with the individual income tax provision.

The most notable technical change is the repeal of the sales tax exemption for Bibles in section 17 of the act. The federal courts ruled this tax exemption unconstitutional in 1990. Because the exemption cannot be enforced, its repeal is not a substantive change.

The remaining sections of this act modernize the language in many of the statutes so that it reads more clearly, remove redundant language, correct incorrect cross references, or repeal unnecessary provisions relating to statutes whose purposes have been accomplished or to statutes that have been amended or repealed.

Recommended by the Revenue Laws Study Committee.

1991 Chapter 46 (House Bill 10, Rep. Lilley)

AN ACT TO ALLOW LESSORS AND RENTERS OF MOTOR VEHICLES TO ELECT TO PAY HIGHWAY USE TAX ON MOTOR VEHICLES OWNED ON OCTOBER 1, 1989, AND TO CLARIFY THAT THESE MOTOR VEHICLES ARE OTHERWISE SUBJECT TO THE GROSS RECEIPTS TAX.

This act gives lessors and renters of motor vehicles the option of paying the highway use tax rather than the alternate gross receipts tax on motor vehicles owned on October 1, 1989, and clarifies the tax status of these motor vehicles. It became effective upon ratification, April 23, 1991.

The 1989 Highway Trust Fund legislation repealed the sales tax on motor vehicles effective October 1, 1989, imposed a titling tax on motor vehicles, and gave lessors and renters of motor vehicles an option of either paying the new 3% titling tax when purchasing a vehicle for lease or rental or waiving payment of the titling tax and collecting a tax on the gross lease or rental receipts. The gross receipts tax is 8% on short-term rentals (less than one year) and 3% on long-term rentals. The law did not give lessors and renters an option of paying titling tax on vehicles owned on the effective date of the change.

The act allows lessors and renters of motor vehicles to elect to pay the 3% highway use tax on motor vehicles owned by them on October 1, 1989, the effective date of the tax change. In doing so, it gives them the same option on their existing inventory that they have on vehicles purchased since October 1, 1989.

A lessor or renter who elects to pay the titling tax under the proposal will pay tax based on the retail value of the vehicle. The retail value for these motor vehicles is the wholesale book value of the vehicle as determined in accordance with schedules of value adopted by the Commissioner of Motor Vehicles. The retail value may be less than or greater than the lessor's or renter's book value of the vehicle, which is based on cost less depreciation.

Taxes collected on motor vehicles owned on October 1, 1989, and leased on or after that date will be credited to the General Fund. It was estimated that this act will generate a one-time revenue increase to the General Fund of $1 million to $1.5 million for the 1991-92 fiscal year.

Because the 1989 Highway Trust Fund legislation provided that the highway use tax applied to vehicles titled on or after October 1, 1989, it was not entirely clear what tax applied to leases made or renewed on or after October 1, 1989, that involved a motor vehicle owned as of October 1. The pre-1989 law did not apply and, arguably, the new highway use tax law with its alternate gross receipts tax had not been triggered because no vehicle had been titled. This act clarifies that those motor vehicles owned on October 1, 1989, that are leased on or after that date are subject to the alternate gross receipts tax and pay tax at the applicable 3% or 8% rate.

Recommended by the Revenue Laws Study Committee.

1991 Chapter 64 (House Bill 343, Rep. Cunningham)

AN ACT TO AUTHORIZE THE CITY OF CHARLOTTE TO REDUCE ITS PRIVILEGE LICENSE TAX PENALTIES AND TO AUTHORIZE CERTAIN CITIES TO ALLOW CREDITS FOR PRIVILEGE LICENSE TAX PENALTIES.

This act makes two local changes to the penalties that apply to failure to obtain a city privilege license. First, effective July 1, 1991, it allows the City of Charlotte to reduce the amount of the penalty payable by those who engage in business in Charlotte without obtaining a required privilege license. Second, from April 30, 1991, to October 1, 1992, it allows any city with a population of at least 380,000 to give a tax credit against the city's privilege license taxes for the amount of any penalties paid to the city for failure to obtain a required privilege license.

Although the second change would apply to any city that meets the population threshold, Charlotte is in fact the only city that meets this description. Raleigh, the next most populous city, has a population of 207,000. The second change is written to apply to any city that fits the description to avoid violating Article II, 24(1)(i) of the North Carolina Constitution. That provision prohibits local acts that remit penalties or refund money paid into the public treasury.

1991 Chapter 77 (Senate Bill 347, Sen. Smith)

AN ACT TO PROVIDE THAT THE COUNTY TAX ASSESSOR SHALL MAKE CERTAIN TAXPAYER BUSINESS RECORDS AVAILABLE TO THE EMPLOYMENT SECURITY COMMISSION ON REQUEST.

Effective May 8, 1991, this act allows county assessors to share certain information about business property with the Employment Security Commission. The act applies to information about business property that is provided to an assessor at the assessor's request and is in addition to the information contained on the property tax abstract for the business. Under prior law, the Employment Security Commission could obtain information included on a property tax abstract because abstracts are public documents, but could not obtain any additional information provided at the assessor's request because the law prohibited an assessor from disclosing the additional information to anyone other than an employee of the Department of Revenue.

1991 Chapter 79 (House Bill 9, Rep. Lilley)

AN ACT TO REINSTATE SALES TAX ON MOPEDS, TOW DOLLIES, AND CERTAIN VEHICLE BODIES AND TO ESTABLISH A UNIFORM LONG-TERM LEASING RATE.

This act corrects several problems created by the 1989 Highway Trust Fund legislation. Effective July 1, 1991, it reinstates the sales tax on mopeds, tow dollies, and certain motor vehicle bodies that were subject to sales tax prior to October 1, 1989. It also eliminates the two-tiered long term leasing rate and replaces that rate with a flat rate effective July 1, 1991.

The Highway Trust Fund legislation exempted motor vehicles from the 2%, $300 maximum sales tax and made them subject to the 3%, $1,000 maximum highway use tax. The highway use tax is triggered when a certificate of title is issued by the Division of Motor Vehicles. Although mopeds and tow dollies were considered motor vehicles, they did not need to be titled. Therefore, they were not subject to either the highway use tax or the sales tax. This

act excludes mopeds and tow dollies from the sales and use tax definition of motor vehicle and, consequently, subjects them to the 4% State sales tax rate and the 2% local sales tax rate.

The act also reinstates sales tax on motor vehicle bodies that are installed on motor vehicle chassis that are already titled. These motor vehicle bodies were specifically exempted from sales tax in the Highway Trust Fund legislation as a result of an erroneous assumption that a chassis receiving a new body would be retitled and would thus be subject to the highway use tax. The act makes these motor vehicle bodies subject to the 4% State sales tax rate and the 2% local sales tax rate.

In addition to closing gaps in taxation, the act changes the taxation of leases and rentals of motor vehicles. A retailer who leases or rents motor vehicles may either pay the highway use tax or elect to pay a tax on the gross receipts of the lease or rental of the vehicle. Under prior law, the rate of tax on the gross receipts was 8% for the first 90 days of a lease or rental to the same person and 3% thereafter. This two-tiered rate was costly to administer and was forcing many lessors to pay the highway use tax rather than exercise the option of paying on gross receipts. This act replaces the two-tiered rate with a flat 8% short-term lease or rental rate and a flat 3% long-term lease or rental rate. A long-term lease or rental is a written lease or rental for at least one year. A short term rental or lease is any other rental or lease. Gross receipts taxes collected at the 8% rate are credited to the General Fund and taxes collected at the 3% rate are credited to the Highway Trust Fund.

The act is expected to generate a maximum of $50,000 annually for the General Fund. The revenue increase to the General Fund generated from the levy of sales tax on mopeds, tow dollies, and motor vehicle bodies is expected to be slightly greater than the decrease in revenues to the General Fund from changing the gross receipts tax rate for long-term leases from a two-tiered rate that includes an 8% rate for 90 days to a flat 3% rate.

Recommended by the Revenue Laws Study Commission.

1991 Chapter 110 (House Bill 51, Rep. Rhodes)

AN ACT TO CONSOLIDATE AND REVISE STATUTES CONCERNING THE PROPERTY TAX COMMISSION, TO REPEAL UNNECESSARY DUTIES OF THE DEPARTMENT OF REVENUE, TO REPEAL THE REQUIREMENT THAT ALL OF THE EMPLOYEES IN THE DEPARTMENT OF REVENUE TAKE AN OATH, AND TO CONFORM THE OATHS REQUIRED BY THE OFFICEHOLDERS IN THE DEPARTMENT OF REVENUE TO THE OATH REQUIRED BY THE CONSTITUTION.

Effective May 23, 1991, this act made several clarifying changes to the property tax statutes. First, it moved the provisions governing the creation, membership, and organization of the Property Tax Commission from Chapter 143B of the General Statutes to Chapter 105 of the General Statutes. Chapter 105 contains a Subchapter on property taxes and is a more logical place for these provisions. The move does not in any way change the membership of the Property Tax Commission or compensation or duties of the members of the Commission.

Second, the act moves several provisions concerning property tax duties of the Department of Revenue into G.S. 105-289, the statute that lists the duties of the Department, and deletes the requirement that the Department report to the Governor and to the General Assembly the proceedings of the Property Tax Commission and any recommendations to change the property tax statutes. These reporting requirements are unnecessary because the

Department regularly provides information and reports to various legislative study committees and commissions.

Third, the act revises the provisions relating to oaths to delete the requirement that all employees of the Department of Revenue take the same oath as is taken by Property Tax Commission members and to replace the oath contained in several property tax statutes with a reference to the oath required of officeholders by Article VI, 7 of the North Carolina Constitution. The statutory requirement that all employees of the Department of Revenue take an oath of office was inappropriate because most employees of the Department do not hold an office and should therefore not be required to take an oath of office. Repetition of the oath set out in the North Carolina Constitution is unnecessary.

Recommended by the Property Tax Study Commission.

1991 Chapter 157 (House Bill 462, Rep. Miller)

AN ACT TO AUTHORIZE DEPARTMENT OF REVENUE EMPLOYEES TO SERVE CIVIL SUMMONSES AND OTHER CIVIL PAPERS.

To ascertain the tax liability of a person, the Secretary of Revenue has the power to examine any documents that may be relevant to the question. Although the law gives the Secretary the authority to summon the person who is liable for the tax or is responsible for the necessary documents, it does not say who may serve the summons. Effective July 1, 1991, Department of Revenue employees may serve these special administrative summonses along with other legal documents in civil matters to which the Secretary is a party. In the past, the Department depended upon the resources of the sheriffs' departments. This process often involved needless delay and expense. A summons is often used to obtain information concerning tax liability when the information is not voluntarily made available.

1991 Chapter 160 (House Bill 745, Rep. Nesbitt)

AN ACT TO PROVIDE A GRACE PERIOD FOR MILITARY PERSONNEL TO LIST AND PAY PROPERTY TAXES AFTER DEPLOYMENT OR ACTIVE DUTY.

This act gives military personnel deployed in the Persian Gulf conflict of 1990-91, commonly referred to as Operation Desert Storm and Operation Desert Shield, 90 days after the end of their deployment to pay their 1990-91 property taxes without interest and to list property for the 1991-92 tax year. Property taxes for the 1990-91 fiscal year would otherwise be due September 1, 1990, and interest would begin to accrue on the taxes from January 6, 1991. The regular listing period for property taxes for the 1991-92 year ended on January 31, 1991.

The act is effective retroactively as of August 2, 1990. The 1991 General Assembly passed a similar act, Chapter 439, that gives personnel deployed in Operation Desert Storm or Operation Desert Shield an extension of 180 days in which to file a State income tax return.

1991 Chapter 182 (Senate Bill 112, Sen. Winner)

AN ACT TO MAKE ANNUAL SPECIAL FUEL REPORTS DUE THE SAME TIME AS ANNUAL MOTOR CARRIER REPORTS AND TO MAKE CONFORMING CHANGES TO THE MOTOR CARRIER LAWS TO FACILITATE ANNUAL MOTOR CARRIER REPORTS.

This act resolves a conflict in reporting dates for persons eligible to file annual road tax reports and diesel fuel reports. It changes the filing period for annual diesel fuel reports from a calendar year to a fiscal year so that both the annual road tax report and the diesel fuel tax report are due at the same time. This change will simplify reporting for the taxpayers and the Department of Revenue. The conflict arose after the General Assembly enacted Chapter 1050 of the 1989 Session Laws. That act allowed a motor carrier whose annual liability for the road tax is less than $200.00 to file an annual report rather than a quarterly report. The allowed annual report covers a fiscal year rather than a calendar year. Chapter 1050 also allowed a user of diesel fuel to file a report on an annual basis if the user is allowed to file an annual road tax report. The act set the filing period for the diesel fuel report on a calendar year basis, however, rather than on a fiscal year basis.

The act also clarifies how the motor carrier who files an annual report should compute the amount of tax liability or credit. The road tax on motor carriers is set at the same rate as the per gallon excise tax. The per gallon excise tax rate has two components--a flat tax of 17¢ a gallon and a variable component equal to the greater of 3 1/2¢ a gallon or 7% of the weighted average wholesale price of gasoline and No. 2 diesel fuel for the most recent six-month base period. In computing the tax liability or credit for a motor carrier filing on an annual basis, the act provides that the average of the two variable cents-per-gallon rates of tax in effect during the year should be used.

This act was effective upon ratification, June 3, 1991.

Recommended by the Revenue Laws Study Committee.

1991 Chapter 193 (House Bill 8, Rep. Lilley)

AN ACT TO IMPROVE THE ADMINISTRATION OF THE HIGHWAY TRUST FUND AND TO MAKE TECHNICAL CHANGES TO THE LAWS AFFECTED BY THE HIGHWAY TRUST FUND.

This act makes two administrative changes and numerous technical changes to the highway use tax statutes. The General Assembly enacted the highway use tax in 1989 as a source of revenue for the North Carolina Highway Trust Fund, the funding source for a $9.1 billion highway program. The 3%, $1,000 maximum "highway use tax" replaced the 2%, $300 maximum sales tax on motor vehicles.

The first administrative change became effective July 1, 1991, and gives the Division of Motor Vehicles the authority to revoke or suspend a motor vehicle dealer's license if the dealer submits a bad check to the Division in payment of the highway use tax. The highway use tax must be paid before a certificate of title is issued for a motor vehicle. Because many motor vehicle dealers apply for a certificate of title for vehicles bought from them, the law allows a dealer to collect the highway use tax payable on a motor vehicle and remit the tax to the Division when the dealer applies for a title on behalf of the buyer of the motor vehicle. During the first year the highway use tax was in effect, the Division received over $15,000 in bad checks from dealers in payment of the tax. Under prior law, the only remedy available to the Division was to remove the registration plate from any vehicle for which a bad check was given

in payment of the highway use tax. It did not seem fair, however, to remove the plate from a vehicle when the owner of the vehicle paid the tax to a dealer and the dealer submitted a bad check to the Division.

The second administrative change clarifies that the Department of Revenue has the same authority to audit those who elect to pay the gross receipts tax on the lease or rental of motor vehicles that it has to audit those who remit sales and use taxes and gives the Division of Motor Vehicles the specific authority to request the Department of Revenue to conduct an audit of a person who pays the gross receipts tax. Prior to the highway use tax legislation, the gross receipts tax on the lease or rental of motor vehicles was part of the sales tax law and was administered by the Department of Revenue. Under current law, the gross receipts tax is an elective alternate to the highway use tax and is set out in the highway use tax statutes. Although the tax is collected by the Department of Revenue, the highway use tax statutes are administered by the Division of Motor Vehicles.

In addition to the administrative changes, the act makes the following technical changes:

(1) It deletes an inaccurate reference in G.S. 105-187.6(b)(4) to the filing of a security interest in a motor vehicle with the Secretary of State. Security interests in most motor vehicles are perfected by filing with the Division of Motor Vehicles, rather than the Secretary of State.

(2) It deletes G.S. 105-436 because it conflicts with G.S. 105-445 and is unnecessary. G.S. 105-436 states that gas tax revenue is to be credited to the Highway Fund, but G.S. 105-445 requires 75% of gas tax revenue to be credited to the Highway Fund and 25% to be credited to the Highway Trust Fund. The provisions in G.S. 105-436 on payment of the gas tax by distributors duplicate G.S. 105-434(b).

(3) It allocates gas tax refunds made to the Cherokee Tribe between the Highway Fund and the Highway Trust Fund in accordance with the 75%/25% split for other refunds.

(4) It deletes unnecessary and inaccurate language in G.S. 20-57(b) concerning the fee imposed for issuing a copy of a registration card for a motor vehicle. G.S. 20-85 sets the fee at $10.00.

(5) It deletes unnecessary and inaccurate language in G.S. 20-85 concerning an exception to the fee schedule set in that statute. G.S. 20-68 does not contain an exception to the fee schedule in 20-85 and has not since 1975.

(6) It corrects a cross reference to the statute that required highway use tax revenue to be credited to the Highway Trust Fund.

Except as otherwise noted, the provisions of the act became effective upon ratification, June 3, 1991. The act does not have any revenue impact.

Recommended by the Revenue Laws Study Committee.

1991 Chapter 213 (House Bill 1047, Rep. Lilley)

AN ACT TO ELIMINATE DOUBLE TAXATION OF ALARM SYSTEMS INSTALLERS LICENSED BY THE ALARM SYSTEMS LICENSING BOARD.

G.S. 105-51.1 imposes an annual privilege license tax on alarm system businesses licensed by the Alarm Systems Licensing Board pursuant to Chapter 74D of the General Statutes. Alarm systems businesses that must be licensed under Chapter 74D and pay the tax under G.S. 105-51.1 are those businesses whose sale, installation, or other service of alarm systems involves entry into the customer's residence or place of business. Businesses that merely sell smoke alarms or other security devices over the counter are not licensed under Chapter 74D or taxed under G.S. 105-51.1.

G.S. 105-102.5 levies a general business license on certain businesses, including a business that sells "burglar alarms, smoke alarms, or other warning devices." (G.S. 105-102.5(b)(3)). The intent of G.S. 105-102.5, enacted in 1989, was to eliminate situations in which a taxpayer was required to obtain more than one privilege license for the same business. Nonetheless, the statute could be construed to levy a duplicate license tax on alarm systems businesses already taxed under G.S. 105-51.1.

Consistent with the original intent of G.S. 105-102.5, this act provides that an alarm systems business that is required to be licensed under G.S. 105-51.1 does not have to pay the privilege license tax under G.S. 105-102.5 for the same location. Businesses that sell alarms over the counter but do not enter the customer's premises, and thus are not taxed under G.S. 105-51.1, will continue to be taxed under G.S. 105-102.5. The act became effective July 1, 1991.

1991 Chapter 221 (House Bill 11, Rep. Lilley)

AN ACT TO APPLY THE TIRE TAX, USED TO PAY FOR THE DISPOSAL OF SCRAP TIRES, TO NEW TIRES FOR ROAD CONSTRUCTION EQUIPMENT AND OTHER NEW VEHICLE TIRES.

This act recodifies the scrap tire disposal "fee" as a tax under the Revenue Act and expands the scope of the levy to include certain new tire transactions that were previously exempt. The 1989 General Assembly imposed a scrap tire disposal "fee" on new motor vehicle tires sold at retail. Because the levy applied only to motor vehicle tires and only to tires sold at retail, not all new tires were subject to the fee.

The definition of motor vehicle that applied to the fee excluded farm equipment, road construction equipment, and special mobile equipment and did not include aircraft. Therefore, a new tire for an airplane or a new tire for a tractor, an earth mover, a well-drilling rig, or any other vehicle that fell in a category of vehicles excluded from the definition of motor vehicle was not subject to the fee. The definition of retail sale that applied to the fee excluded sales of tires that are placed on a motor vehicle offered for sale, lease, or rental. Therefore, new tires sold for used cars offered for sale, lease, or rental by a dealer were also excluded from the fee.

The General Assembly found that the limitation of the scrap tire disposal fee to motor vehicle tires and to tires sold at retail was not consistent with the purpose of the fee. As stated in G.S. 130A-309.54, the purpose of the fee is to provide funds for the disposal of scrap tires. By limiting the fee to motor vehicle tires and to tires sold at retail, however, many tires that contribute to the disposal problem were not subject to the fee.

Accordingly, effective July 1, 1991, this act extends the scrap tire disposal fee to new tires for the following vehicles:

(1) Farm tractors and other farm vehicles.

(2) Graders, earth movers, and other construction vehicles.

(3) Well-drilling rigs, truck cranes, and other vehicles that are included in the class of vehicles known as special mobile equipment. Vehicles in this class are registered with the Division of Motor Vehicles but drive on the road only to get to an off-road job.

(4) Used vehicles offered for sale, lease, or rental by a dealer.

(5) Aircraft.

The act does not change the current exemptions for tires for vehicles propelled by human power, such as bicycles, and for recapped tires.

Because the proceeds of the scrap tire tax go to the Solid Waste Management Trust Fund and to counties, this act does not affect the General Fund. It will generate approximately $150,000 in additional revenue for the Solid Waste Management Trust Fund each year.

In addition to these substantive changes, the act makes two technical changes: it moves the levy of the fee from Chapter 130A to Chapter 105 of the General Statutes and renames the levy a tax rather than a fee. Although originally named a "fee", the scrap tire disposal fee is, in fact, a supplemental sales tax and therefore belongs in Chapter 105 of the General Statutes, the tax chapter, rather than in Chapter 130A, the public health chapter, and should be called by its proper name. The use of the word "fee" to describe the tax contradicts the definition of a disposal fee in G.S. 130A-309.53(2) as a charge imposed by a local unit of government or another entity for accepting a tire for disposal.

Based on a recommendation of the Revenue Laws Study Committee.

1991 Chapter 228 (House Bill 445, Rep. Brawley)

AN ACT TO ALLOW DEPARTMENT OF REVENUE EMPLOYEES TO LEVY ON TAXPAYERS' PERSONAL PROPERTY TO COLLECT TAXES TO THE SAME EXTENT AS A LOCAL TAX COLLECTOR.

This act was requested by the Department of Revenue to give the Department the same authority county tax collectors have in levying on personal property to collect delinquent taxes. Under existing law, Department of Revenue employees could collect unpaid taxes by directing the sheriff to levy upon the delinquent taxpayer's real and personal property located in the sheriff's county. By contrast, a local tax collector could levy against a delinquent taxpayer's personal property to collect unpaid property taxes. (G.S. 105-366, 105-367, and 105-368.)

Effective upon ratification, June 5, 1991, this act provides that the Secretary of Revenue may either direct the sheriff to levy upon the delinquent taxpayer's real and personal property or direct a Department of Revenue employee or officer to levy upon and sell the taxpayer's personal property. In the latter case, the property may be sold either in the county in which it was seized or in Wake County, in the Secretary's discretion. This levy by a Department of Revenue employee or officer is governed by the laws that regulate levy and sale under execution.

1991 Chapter 347 (House Bill 276, Rep. Jones)

AN ACT TO PROVIDE FOR THE ADMINISTRATION OF THE POLITICAL PARTIES FINANCING FUND.

This act substitutes the State Board of Elections for the State Treasurer as the person or entity responsible for distributing funds in the North Carolina Political Parties Financing Fund. The act became effective June 20, 1991. The Treasurer will continue to manage the Fund as part of the State Treasury, but the State Board of Elections will determine each political party's share of the Fund and direct the disbursement of funds to each eligible political party.

In changing the responsibility for distributing revenue in the Fund, this act, in combination with Section 9 of Chapter 690 of the 1991 Session Laws, made conforming changes to G.S. 105-159.1. That statute permits a taxpayer to direct that $1.00 of the taxpayer's individual income tax liability be credited to the Fund without increasing or decreasing the amount of any tax refund the taxpayer is otherwise due. The conforming changes to G.S. 105-159.1 parallel those made to the election statutes and make the State Board of Elections, rather than the State Treasurer, responsible for administering distributions from the Fund.

1991 Chapter 356 (Senate Bill 234, Sen. Perdue)

AN ACT TO PERMIT REGIONAL SOLID WASTE MANAGEMENT AUTHORITIES TO RECEIVE ANNUAL SALES TAX REFUNDS.

This act adds regional solid waste management authorities to the list of governmental entities in G.S. 105-164.14(c) that are entitled to an annual refund of both State and local sales and use taxes paid on their direct and indirect purchases of tangible personal property. In addition to all counties and incorporated cities and towns, there are 14 other, primarily local, governmental entities currently entitled to refunds of State and local sales and use taxes. These governmental entities must apply for the refund within six months after the end of each fiscal year. This act became effective upon ratification, June 24, 1991, so regional solid waste management authorities will be able to apply for a refund of taxes paid during the 1990-91 fiscal year. The act is expected to reduce General Fund revenues by no more than $500,000 over the next three fiscal years.

In 1990, the General Assembly enacted Article 22 of Chapter 153A of the General Statutes, which allows two or more local governments to create a regional solid waste management authority. The purpose of an authority is to provide environmentally sound, cost effective management of solid waste, including storage, collection, transportation, separation, processing, recycling, and disposal of solid waste.

1991 Chapter 439 (Senate Bill 697, Sen. Raynor)

AN ACT TO ALLOW AN ADDITIONAL 180-DAY PERIOD FOR DEPLOYED ARMED FORCES PERSONNEL AND SUPPORT PERSONNEL TO FILE STATE TAX RETURNS AND TO CONFORM THE STATE INCOME TAX ABATEMENT PROVISIONS CONCERNING MILITARY PERSONNEL TO FEDERAL LAW.

This act changes North Carolina law in two ways. First, it gives armed forces personnel and support personnel serving in the Persian Gulf conflict of 1990-91, commonly referred to as Operation Desert Shield and Operation Desert Storm, the same amount of time to file a State tax return that federal law gives them to file a federal tax return. In doing so, it waives penalties and interest that might otherwise have accrued during the extension period. Second, it makes a

technical change to the current State provision concerning abatement of State income taxes for persons who die in combat to ensure that the State provision tracks the federal income tax abatement provision.

The extension period for income taxes granted by this act is the number of days during the regular filing period the individual was in the combat zone plus 180 days. The length of the regular filing period, which runs from January 1 to April 15, is 105 days. The maximum 285-day extension is reduced by the number of days of the regular filing period during which the individual had left the combat zone. For example, if the individual returned on February 1, 1991, the extension equals 211 days (31 days of the regular filing period when the individual was in the combat zone plus 180 days).

The act does not give armed forces personnel and support personnel interest on their income tax refunds as does federal law for federal tax refunds. Under federal law, armed forces personnel and support personnel are paid interest on any federal income tax refund due from April 15 until the refund is paid. Under State law, no interest is paid on a refund if the refund is made within six months from the later of the date on which the annual return is filed or the date the annual return is due to be filed.

This act is effective retroactively as of August 2, 1990. The estimated loss to the General Fund for the 1991-92 fiscal year is $272,000. The loss is attributable to the interest that would otherwise be due on returns with tax liability filed after April 15. The General Assembly passed a similar act, Chapter 160, that gives military personnel deployed in Operation Desert Storm or Operation Desert Shield 90 days after the end of their deployment to pay their 1990-91 property taxes without interest and to list property for the 1991-92 tax year.

1991 Chapter 441 (House Bill 46, Rep. Brawley)

AN ACT TO REQUIRE SALES OF BOTH HIGHWAY AND NONHIGHWAY SPECIAL FUEL TO BE REPORTED, TO ELIMINATE THE REQUIREMENT THAT CERTAIN USERS OF SPECIAL FUEL FILE REPORTS SPECIFYING THEIR USE OF SPECIAL FUEL, TO CHANGE THE MAXIMUM BOND REQUIRED OF FUEL DISTRIBUTORS AND SUPPLIERS, AND TO CHANGE THE METHOD FOR DETERMINING THE AMOUNT OF A BOND PAYABLE BY CERTAIN FUEL IMPORTERS.

This act provides a permanent solution to the bonding dilemma addressed temporarily in Senate Bill 110, ratified as Chapter 42 of the 1991 Session Laws, and modifies the licensing and reporting system for the sale of special fuel, which is primarily diesel fuel as opposed to gasoline. The changes to the licensing and reporting requirements become effective January 1, 1992, and will make the administration of the special fuels statutes easier for the Department of Revenue and less cumbersome for the public.

The 1990 General Assembly changed the maximum amount of the bond required from a distributor of gasoline or a supplier of diesel fuel from $40,000 to two times the distributor's or supplier's expected tax liability. Many distributors and suppliers who had a history of timely tax payments had difficulty obtaining bonds at the higher amounts. Chapter 42 of the 1991 Session Laws provided a temporary solution to the problem by reinstating the $40,000 maximum bond amount until July 1, 1991. Effective July 1, 1991, this act sets the maximum bond required of a distributor of gasoline or a supplier of special fuel at $125,000. The maximum bond for a person who is both a supplier and a distributor is $250,000.

The act also establishes a different bonding requirement for importers of gasoline. Under the act, the amount of the bond required of distributors who import or exchange fuel is based on the amount of fuel imported or exchanged rather than the amount of fuel sold to other licensed distributors. These importers have large potential tax liabilities and some have few assets or ties to the State. Under prior law, the bond amount for these importers and traders was based on the amount of tax payable on the sale of gasoline to others. However, no tax is due when an importer or trader sells to a licensed distributor; the tax is due when the purchasing distributor subsequently resells or uses the gasoline.

In addition to changing the bond requirements, the act expands the reporting requirements for special fuel. Beginning January 1, 1992, the act requires all suppliers of special fuel to obtain a license from the Department of Revenue and to report all sales of special fuel. Currently, only suppliers of special fuel to be used for highway purposes are licensed and only sales of special fuel to be used for highway purposes are reported. In addition, the act exempts suppliers of nonhighway fuel from the bonding requirement and allows these suppliers to report sales quarterly instead of monthly.

The act modifies the licensing and reporting requirements for users of special fuel. A user is a person who uses special fuel in a licensed motor vehicle. The act exempts motor carriers who file road tax reports from the reporting requirement, allows the Secretary to waive the reporting requirement for motor carriers who are not required to file road tax reports, exempts users whose vehicles weigh less than 10,001 pounds from both the licensing and reporting requirements, and replaces the reporting requirement for the remaining users with a requirement that the users file an annual statement certifying that they did not use nontaxpaid fuel during the year in their motor vehicles. Currently, all users of special fuel whose vehicles weigh more than 6,000 pounds must file either quarterly or annual reports that list each purchase of fuel, including the date of the purchase, the seller of the fuel, and the amount of the purchase. Many users of special fuel find this report burdensome.

The act relieves certain bulk users of diesel fuel from the requirement of marking storage facilities for the fuel. Under current law, a bulk user of special fuel that is not used for a highway purpose must mark the facility "For Nonhighway Use." The act eliminates the marking requirement when the fuel is used only for heating, drying crops, or a manufacturing process and could not be readily extracted from the storage facility and used for a highway purpose. It also provides that a supplier of special fuel who sells or delivers fuel into a storage facility of a user-seller that is marked for nonhighway use is liable for any tax due on the fuel if the supplier knows or has reason to know that the user-seller intends to use the fuel for a highway purpose.

The act expands the presumption concerning when fuel is taxable to cover fuel that is incorrectly reported as having been purchased for a nonhighway use. Chapter 42 of the 1991 Session Laws clarified the existing presumption by stating that a user-seller who uses more fuel than the user-seller reports is presumed to have acquired the extra fuel tax-free for use in a licensed motor vehicle. Therefore, under the current law, only fuel that is not reported at all rather than falsely reported is presumed taxable.

The act relieves retail sellers of special fuel from the requirement of giving purchasers of special fuel a detailed receipt when the purchaser buys fewer than 25 gallons of fuel for highway purposes and requires a receipt for all sales for nonhighway purposes. Current law requires a user-seller to give a receipt for every retail sale of any amount of special fuel. The receipt must contain the name and address of the purchaser, among other information.

1991 Chapter 453 (Senate Bill 104, Sen. Winner)

AN ACT TO ELIMINATE A TAXPAYER'S DEDUCTION FOR CERTAIN CONTRIBUTIONS OF LAND OR CROPS TO ACCOUNT FOR TAX CREDITS ALLOWED FOR THE SAME CONTRIBUTIONS.

This act makes an adjustment to two individual income tax credit laws to restore to taxpayers the benefits of the credits that were inadvertently limited by the Tax Fairness Act of 1989. It also provides that only one credit is allowed with respect to property owned by a married couple, regardless of the nature of the ownership interest.

G.S. 105-151.12 allows a tax credit of 25% of the value of property donated for land conservation purposes. The maximum credit for a donation of property is $25,000. G.S. 105-151.14 allows a tax credit of 10% of the market price of a crop that the owner allows to be gleaned. When these tax credits were enacted in 1983 and 1984, respectively, they provided that the taxpayer could not also claim a deduction for the donation that was the basis of the credit. In effect, the taxpayer could choose between taking a credit or a deduction for State tax purposes.

Under the Tax Fairness Act of 1989, federal taxable income is the starting point for calculating State taxable income. Separate State tax deductions are therefore eliminated and the deductions taken for federal purposes apply to the State tax as well. To prohibit a double tax benefit for the same donation, the Tax Fairness Act amended these two State tax credits to provide that they could not be taken for amounts that were deducted for federal tax purposes. The effect of the revision, therefore, was to restrict inadvertently the situations in which the tax credit could be used. Under the original law, the taxpayer could choose between the State credit and the State deduction; because the credit provided a greater tax benefit, the taxpayer would normally choose the credit. Under the revised law, the taxpayer had to forgo both the State and federal deductions to receive the credit. This removed the extra incentive for making the donation in the first place.

This act amends the law to reflect its original intent: a taxpayer can choose either the State credit or the State deduction. Claiming the State credit does not affect the federal deduction. The act provides that a taxpayer who claims the State credit must forgo the benefit of the deduction for State tax purposes. If the deduction has already been claimed in determining federal taxable income, the taxpayer must add the amount of the deduction to North Carolina taxable income. The adjustments to the two individual income tax credits are effective retroactively beginning with the 1989 tax year. The average annual loss to individual income tax revenue for the seven-year period these credits have been in effect is $145,000.

Effective for taxable years beginning on or after January 1, 1991, only one credit is allowed with respect to property owned by a married couple, regardless of the nature of the ownership interest. Under prior law, a married couple that owned property by the entirety could take only one credit for a donation of the property. However, if the couple had a tenancy in common, each spouse could take a separate credit.

Recommended by the Revenue Laws Study Committee.

1991 Chapter 454 (Senate Bill 114, Sen. Winner)

AN ACT TO REPEAL INHERITANCE TAX EXEMPTIONS FOR CERTAIN TYPES OF PROPERTY.

This act revises the State inheritance tax exemptions to reflect changes made to the inheritance tax laws in 1985. It is effective for the estates of decedents dying on or after September 1, 1991.

The act repeals the separate inheritance tax exemptions for the following types of property, each of which is fully taxable under the federal estate tax:

(1) Pension, profit-sharing, and stock bonus plans qualified under section 401 of the Internal Revenue Code and retirement annuity contracts qualified under section 403 of the Internal Revenue Code.

(2) Amounts receivable under individual retirement accounts (IRAs), individual retirement annuities, and individual retirement bonds.

(3) Federal military retirement and survivor benefits.

It repeals these specific exemptions because their purpose, which is primarily to protect property passing to a spouse, children, or grandchildren from inheritance taxation, is accomplished by changes made to the inheritance tax law in 1985. In that year, the General Assembly enacted the spousal exemption and increased the Class A inheritance tax credit to an amount that exempts at least $500,000 of property that passes to lineal ancestors and descendants from tax. Under those changes, any property, including the property listed above, is exempt from inheritance tax if it passes to a spouse and is eligible for application of the Class A credit if it passes to a lineal ancestor or descendant. Repeal of these exemptions is expected to increase revenue to the General Fund by no more than $100,000 annually.

Recommended by the Revenue Laws Study Committee.

1991 Chapter 479 (Senate Bill 107, Sen. Winner)

AN ACT TO SIMPLIFY AND MODERNIZE PRIVILEGE LICENSE TAXES RELATING TO DRY CLEANERS AND LAUNDRIES.

Effective July 1, 1991, this act revises the privilege license taxes payable by laundries (including linen rental businesses) and by dry cleaners. It establishes two categories of State privilege licenses for laundries and dry cleaners and changes local taxation of these businesses.

The two categories of State licenses are a location license and a soliciting license. The location license is payable by a dry cleaner or laundry with a fixed place of business in this State. The soliciting license is payable by a laundry or dry cleaner that does not have a fixed place of business in this State but enters the State to pick up clothes or other articles to be cleaned or pressed at a place outside the State.

The State privilege tax for a location license is $50.00 if the business operated at the location does not also have vehicles pick up items from outside the county where the business is located to be cleaned or pressed at the business location. The State privilege tax for a location license is $100.00 if the business operated at the location also has vehicles pick up items from outside the county where the business is located to be cleaned or pressed at the business location. The State privilege tax for a soliciting license is $100.00. The new tax rates are not expected to have a significant impact on the General Fund.

Under prior law, each dry cleaner or laundry was required to obtain one $50.00 State license for each fixed location and an additional $50.00 State license for each city or town,

other than the one where it is located, to which it sent vehicles to pick up items to be cleaned or pressed, unless there was not another similar business in that city or town. In addition, a dry cleaner or laundry that had a fixed location only in another state and sent a vehicle into this State to pick up items to be cleaned or pressed was required to obtain a $200.00 State license for each vehicle. These prior provisions were apparently designed to hamper statewide competition and to inhibit competition from out-of-state businesses. The provisions were exceedingly complex and the out-of-state provision was arguably unconstitutional. The new law will simplify State administration and taxpayer compliance.

This act also changes the local privilege license taxes that can be levied on laundries and dry cleaners by counties and municipalities. The prior law was complex. Counties were not authorized to levy a tax on dry cleaners located in the State, but they could levy a tax of up to $200.00 on out-of-state dry cleaners that solicited in the county. Counties were authorized to tax laundries that entered the county to pick up items to be laundered if the actual laundering location was outside the county. If the location was outside the county but inside the State, the county could levy a tax of up to $12.50 on the business; if the location was outside the State, the county could levy a tax of up to $200.00 on each vehicle entering the county.

Under prior law, municipalities with a population of less than 10,000 could levy an annual tax of up to $25.00 on dry cleaners; municipalities with a population of 10,000 or more could levy an annual tax of up to $50.00 on dry cleaners. Municipalities had the same authority as counties to tax laundries: they could levy a tax of up to $12.50 on laundries and linen rental businesses entering the municipality to pick up items to be laundered if the actual laundering location was outside the municipality but inside the State. If the location was outside the State, the municipality could levy a tax of up to $200.00 on each vehicle entering the municipality.

This act simplifies local taxation of these businesses. It provides that municipalities may tax each dry cleaner or laundry that has a place of business in the municipality. The rate of tax may not exceed the State location rate. Both counties and municipalities may tax businesses that do not have a fixed place of business in this State but enter the county or municipality to pick up clothes or other articles to be cleaned at a place located outside the State. The rate of tax may not exceed the State soliciting rate.

Based on a recommendation of the Revenue Laws Study Committee.

1991 Chapter 487 (House Bill 23, Rep. Lilley)

AN ACT TO MODIFY THE FUEL TAX STATUTES TO ENABLE NORTH CAROLINA TO ENTER THE INTERNATIONAL FUEL TAX AGREEMENT.

This act changes several provisions in the motor fuel tax statutes to enable North Carolina to enter the International Fuel Tax Agreement (IFTA). As of December 1, 1990, at least sixteen states belonged to the IFTA and four more, including North Carolina, had indicated a desire to join. The sixteen member states are primarily Midwestern and western states. If North Carolina joins, several other southeastern states are expected to follow suit. The act becomes effective January 1, 1992, the date North Carolina expects to become a member of the IFTA. It is estimated that this act will increase State revenues by $137,500 in the 1991-92 fiscal year and $275,000 in the 1992-93 fiscal year. Three-fourths of the new revenue will be credited to the Highway Fund and the remainder will be credited to the Highway Trust Fund.

The IFTA is an agreement between member taxing jurisdictions to assist each other in the collection and administration of taxes paid by interstate motor carriers on their use of motor

fuel. These taxes are frequently referred to as road taxes or highway use taxes and are not to be confused with the motor vehicle titling tax enacted in 1989 that is also referred to as a highway use tax. The road tax is a tax on the amount of fuel a motor carrier uses in its operations in a state. The tax is at the same rate as the state's per gallon excise tax on motor fuel and a credit is given for excise taxes paid to the state on motor fuel. Thus, the purpose of the tax is to tax motor carriers who drive in a state using fuel purchased in another state.

Under the IFTA, a motor carrier declares one member jurisdiction to be the carrier's base jurisdiction for registering the carrier's vehicles for purposes of the road taxes and reporting the taxes due to all the member jurisdictions. The base jurisdiction then collects the road taxes payable by the motor carrier to every member jurisdiction and remits the taxes collected to the appropriate jurisdictions. By centralizing the payment and collection of road taxes, the agreement greatly simplifies the payment of road taxes by motor carriers and the collection of road taxes by the member jurisdictions.

The IFTA requires a member jurisdiction to agree to certain administrative provisions to ensure uniformity among the participating jurisdictions. Some of North Carolina's statutes conflict with these provisions and must be changed in order for North Carolina to be able to enter the IFTA. This act makes the necessary changes.

Section 1 changes the law on who is a user of special fuel, which is primarily diesel fuel, for reporting fuel consumed by a leased motor vehicle. G.S. 105-449.10 requires a user of special fuel to file periodic reports of fuel use. For leased motor vehicles, the question is whether the lessor or lessee must file the report.

Under existing law, the lessee is required to file the report unless the lessor supplies the fuel, pays for the fuel, or includes the cost of fuel in the lease and elects to be the lessee. Under the act, beginning January 1, 1992, the one who is designated as the motor carrier with respect to the leased vehicle must file the report. If the leased vehicle is not subject to the road tax and, consequently, neither the lessor nor the lessee is a motor carrier with respect to the vehicle, the one who is liable for payment for the fuel consumed by the leased vehicle must file the report.

Section 2 modifies the exemptions from the road tax to ensure that the same vehicles are subject to road tax in each member jurisdiction under the IFTA. It rewrites the definitions of "motor carrier" and "motor vehicle" to delete the existing exemptions for vehicles operated by nonprofit organizations and retain the exemptions for vehicles operated by the United States, vehicles operated by the State or a political subdivision of the State, and special mobile equipment.

Section 3 modifies the refund provisions of the road tax to ensure that a motor carrier who registers under the IFTA is subject to the same refund provisions in each member jurisdiction of the IFTA. The modified provision will allow the Secretary of Revenue discretion to refund excess motor fuel excise taxes paid by a motor carrier without first auditing the motor carrier's records or requiring the motor carrier either to furnish a bond or to establish a one-year history of compliance with the motor fuel tax laws. Under existing law, the Secretary may not refund excess tax paid by a motor carrier unless the Secretary audits the carrier or the carrier either furnishes a bond or has a one-year history of compliance with the motor fuel tax laws.

Section 4 enables the Secretary of Revenue to require a motor carrier to furnish a bond in certain circumstances and raises the maximum bond from $10,000 to four times a carrier's expected liability or refund. Under existing law, a motor carrier is required to furnish a bond only if the carrier wants a refund of taxes paid and does not have a one-year history of compliance with the motor fuel tax laws. Under the act, beginning January 1, 1992, the

Secretary can require a motor carrier to file a bond when the motor carrier fails to file a report or pay tax when due or if the Secretary determines after auditing the motor carrier that a bond is needed to protect the State from loss. The maximum bond required under existing law is $10,000. Section 4 increases the maximum bond to four times the carrier's liability to North Carolina to reflect the increase in the amount of taxes that will be collected by North Carolina as the base state. For motor carriers who designate North Carolina as their base jurisdiction, North Carolina will collect road taxes payable to all the other member jurisdictions.

Section 5 is a companion change to the change made in Section 1 concerning leased motor vehicles. This section changes the law on who, between the lessor and lessee of a leased motor vehicle, is considered the motor carrier and must consequently file periodic road tax reports and pay the road tax. Under existing law, the lessee is the motor carrier unless the lessor supplies the fuel, pays for the fuel, or includes the cost of fuel in the lease and elects to be the lessee. Under the act, who between the lessor and the lessee is the motor carrier will differ depending on whether the lessor is a company that is regularly engaged in the leasing business or is an independent contractor and owner-operator of a truck or other vehicle. If the lessor is regularly engaged in the leasing business, the lessor is the motor carrier unless the lessor and lessee agree that the lessee is the motor carrier and the lessee notifies the Secretary of Revenue. If the lessor is an independent contractor, the lessee is the motor carrier unless either the motor vehicle whose operations must be reported is leased for fewer than 30 days or the motor vehicle is leased for at least 30 days, the lessor and lessee agree that the lessor is the motor carrier, and the lessor notifies the Secretary of Revenue.

Section 6 modifies the procedure for registering a motor carrier and its fleet for purposes of the road tax. The modifications are made to accommodate the registration procedures under the IFTA. The section changes current law by requiring registration of both a motor carrier and each vehicle in the carrier's fleet and by eliminating the requirement that each identification marker for a vehicle have a unique identifying number. Under existing law, each motor vehicle operated by a motor carrier is registered with the Department of Revenue and the motor carrier is not separately registered. The Department assigns a unique number to each registered motor vehicle and issues a registration card, which is carried in the cab of the motor vehicle, and an identification marker, which is placed on the vehicle. Under the IFTA, registration focuses on the motor carrier, and both the motor carrier and the vehicles in the carrier's fleet are registered. A unique number is assigned to each motor carrier but not to each motor vehicle in a carrier's fleet. An identification marker is issued for each vehicle in the carrier's fleet but the marker identifies the vehicle as part of a certain carrier's fleet. A copy of the motor carrier's registration must be carried in the cab of each motor vehicle and the vehicle's identification marker must be placed on the vehicle.

Section 7 eliminates the current credit against the road tax for any temporary permit fee paid. No other state allows this credit. Under existing law, a motor carrier may operate for no more than 20 days in this State without registering for payment of the road tax if the carrier applies for and receives a temporary permit. The fee for a temporary permit is $25.00. Under existing law, if the motor carrier files a road tax report for its temporary operations, the carrier can receive a credit against the road tax for its temporary permit fee. If the carrier's operations were exclusively intrastate, it can obtain a refund of the temporary permit fee by filing a report. This section eliminates both the credit and the refund.

Recommended by the Revenue Laws Study Committee.

1991 Chapter 517 (House Bill 1236, Rep. Rogers)

AN ACT TO CONFORM THE CRITERIA FOR DESIGNATION AS A DISTRESSED COUNTY FOR INCOME TAX PURPOSES TO THE CRITERIA USED BY THE INDUSTRIAL DEVELOPMENT FUND, TO INCREASE THE NUMBER OF SEVERELY DISTRESSED COUNTIES TO THIRTY-THREE, AND TO REPEAL THE SUNSET.

In 1987 the General Assembly created a tax credit for individuals and corporations that hired additional full time employees in a severely distressed county. Under current law, a county is considered severely distressed if its distress factor is one of the 25 highest in the State. The Secretary of Economic and Community Development assigns a distress factor to each county in the State at the end of each calendar year. The factor is based on the sum of the county's rank by rate of unemployment, from lowest to highest, and its rank by per capita income, from highest to lowest, averaged over a three year period. As enacted, the credit would have expired for taxable years beginning on or after January 1, 1993.

This act increases the number of severely distressed counties from 25 to 33, removes the sunset on the credit, and adds a third criteria to be used in determining whether or not a county is severely distressed. The third criteria is the county's rank by percentage of growth in population from lowest to highest. The addition of this third criteria conforms the criteria for designation as a severely distressed county to the criteria used in determining which counties may benefit from the Industrial Development Fund under G.S. 143B-437A.

This act becomes effective for taxable years beginning on or after January 1, 1992. Through May 1991, the cost of this tax credit in fiscal year 1990-91 was approximately $300,000. This figure represents 1/4 of the total tax credits available to employers because the $2,800 maximum credit must be taken in equal installments over a four-year period. It is estimated that increasing the number of severely distressed counties to 33 will add at least an additional $100,000 to the cost of the credit on a fiscal year basis. However, no additional cost will be incurred until fiscal year 1993 because the credit must be taken in the taxable year after the job has been created.

1991 Chapter 538 (House Bill 1222, Rep. Nesbitt)

AN ACT TO AMEND VARIOUS STATUTES RELATING TO THE CLEANUP OF LEAKING PETROLEUM UNDERGROUND STORAGE TANKS, TO INCREASE THE PER GALLON FUEL EXCISE TAX, AND TO DEDICATE THE PROCEEDS OF THE TAX INCREASE TO THE CLEANUP OF LEAKING PETROLEUM UNDERGROUND STORAGE TANKS.

This act revises the law on leaking underground petroleum storage tanks in various ways to encourage the replacement of these tanks and to ensure that sufficient funds are available to clean up the environmental damage caused by them. As part of the effort to provide adequate funds for the clean-up, the act increases the per gallon excise tax on motor fuels for a limited period of time and earmarks the revenue for this purpose.

Effective January 1, 1992, the act increases the per gallon excise tax on motor fuels by 1/2¢ a gallon, dedicates one-half of the increased revenue to the Commercial Leaking Petroleum Underground Storage Tank Fund, established under G.S. 143-215.94B, and dedicates the remaining one-half to the Groundwater Protection Loan Fund, which the act creates in new G.S. 143-215.94P. Effective January 1, 1995, the act reduces the 1/2¢ increase by 1/4¢ a gallon and eliminates the dedication of revenue to the Loan Fund. Thus, when the 1995 changes take effect, the per gallon tax will be 1/4¢ more a gallon than it is now and all the revenue from the increase will be earmarked for the Commercial Tank Fund. Effective January 1, 1999, the changes to the per gallon tax made in 1992 and 1995 are repealed.

1991 Chapter 539 (House Bill 1224, Rep. Mavretic)

AN ACT TO PROVIDE AN INCENTIVE FOR THE USE OF RECYCLED NEWSPRINT BY REQUIRING PUBLISHERS WHO DO NOT USE A MINIMUM AMOUNT OF RECYCLED NEWSPRINT TO PAY A TAX ON NONRECYCLED NEWSPRINT.

To encourage the use of recycled newsprint, this act imposes a privilege license tax on those who produce publications printed on newsprint and do not use a minimum amount of recycled paper. The tax becomes effective October 1, 1991, and is payable quarterly. The tax rate is $15.00 for each ton of newsprint that is consumed during a reporting period and has an average recycled content percentage that is less than the required minimum recycled content percentage. The proceeds of the tax are earmarked for the Solid Waste Management Trust Fund created under G.S. 130A-309.12. The act is expected to generate no more than $90,000 for fiscal year 1991-92 and each subsequent year.

The average minimum recycled content requirement for newsprint consumed by a producer each quarter increases over a six-year period. From 1991 to 1997, the percentage of required recycled content gradually increases from 12% to 40%. After 1997, the percentage remains at 40%.

The tax does not apply in a few circumstances. It does not apply to newsprint that is acquired by a producer and then recycled by the producer. It also does not apply if the producer of a publication could not meet the required minimum recycled content standards for one or more of several reasons. The reasons are an inability to obtain newsprint made from recycled paper at a price or quality comparable to other newsprint, in an amount needed for a publication, or in a reasonable amount of time. A producer who claims an exemption for one of these reasons must document the producer's effort to obtain newsprint that contained the required minimum percentage of recycled paper.

Assuming a producer did not recycle any newsprint acquired and had no reason for not using newsprint with the appropriate recycled content, a producer would compute the tax due under this act by the following procedure. The producer would determine the number of tons of newsprint acquired during a quarter and the recycled content percentage of the acquired newsprint. Assume the producer acquired 100 tons of virgin paper, 100 tons of paper with a recycled content of 20%, and 100 tons of paper with a recycled content of 10%. The producer under this assumption has an average recycled content percentage of 10%.

The producer then multiplies 300 (the number of tons acquired) by 12% (the required percentage for 1991) to get 36, and multiplies 300 (the number of tons acquired) by 10% (the average recycled content of the paper acquired) to get 30. As the final step, the producer subtracts 30 from 36 and multiplies the result, 6, by $15.00 to find that the producer owes a tax of $90.

Because the tax imposed by this act falls on the publication of newspapers, the question arises of whether the act impermissibly interferes with the exercise of the fundamental right to freedom of the press. Given the clear purpose of the act, which is to address a solid waste problem and not interfere with freedom of the press, the amount of the tax, and the exemptions from the tax, the act is likely to withstand a constitutional challenge.

1991 Chapter 584 (House Bill 308, Rep. Abernethy)

AN ACT TO ALLOW LOCAL GOVERNMENTAL UNITS TO CONTRACT WITH FINANCIAL INSTITUTIONS FOR RECEIPT OF PAYMENTS OF DELINQUENT PROPERTY TAXES AND INTEREST AND TO AUTHORIZE LOCAL GOVERNMENTS TO ALLOW PAYMENT OF PROPERTY TAXES BY CREDIT CARD.

This act expands the authority of local governments to contract with financial institutions for collection of property taxes and authorizes tax collectors to allow payment of property taxes by credit card. In 1989, the General Assembly authorized all local governments to contract with a bank or other financial institution to collect property taxes. Before 1989, several local acts authorized specific local governments to contract for this type of property tax collection, popularly known as "lockbox property tax collection." The 1989 act was limited to collection of current taxes only; the financial institution could not collect overdue taxes. Effective upon ratification, July 8, 1991, Section 1 of this act removes that limitation and authorizes local governments to contract with financial institutions for collection of delinquent property taxes and interest as well as current taxes.

Under existing law, tax collectors, and financial institutions that have contracted to collect property taxes for a local government, may accept either cash or checks in payment of property taxes. Effective beginning with the 1991-92 tax year, Section 2 of this act authorizes tax collectors, but not financial institutions, to accept credit cards in payment of property taxes. Like acceptance of a check, acceptance of a credit card is at the tax collector's own risk; the tax collector is individually liable for any loss resulting from acceptance of a credit card. The fee charged to the tax collector by the financial institution for the credit card service will not be borne by the taxing unit; it is to be passed on to the taxpayer. The tax collector may issue a receipt at the time a credit card payment is made or may withhold the receipt until the credit card invoice is honored. Dishonor of a credit card invoice has the same consequences as dishonor of a check; if the tax collector issued a receipt and the credit card invoice is later dishonored, a purchaser for value or a lienholder who in good faith relied upon the receipt has rights superior to the taxing unit's tax lien.

1991 Chapter 598 (House Bill 1039, Rep. Kerr)

AN ACT TO FACILITATE THE CONSTRUCTION OF FACILITIES IN AND THE EXTENSION OF NATURAL GAS SERVICE TO UNSERVED AREAS AND TO REVISE THE PROCEDURES FOR GAS COST ADJUSTMENT FOR NATURAL GAS LOCAL DISTRIBUTION COMPANIES.

This act creates a method to promote expansion of natural gas service into unserved areas of North Carolina where it may not otherwise be economically feasible. Under the act, the Utilities Commission may order a local distribution company to create a special natural gas expansion fund to be used to make the expansion of natural gas services economically feasible. Revenue in the fund may only be used to the extent needed to make the expansion project economically feasible. When the project becomes economically viable, the Commission may require the company to repay either the customers or the fund for the amount spent on the project. The sources of funding for expansion funds include refunds received by local distribution companies from gas suppliers, expansion surcharges on customers when approved by the Commission, and any other source of funding approved by the Commission. The expansion surcharges applied to customers purchasing natural gas or transportation services cannot exceed 15¢ per dekatherm.

To ensure that all of the funds received through customer surcharges are used for the expansion of natural gas services, the act exempts from certain taxes the income received by local distribution companies from the surcharges. In determining State net income, a local distribution company may deduct from federal taxable income the amount of natural gas expansion surcharges collected. On the other hand, the company must add to federal taxable income any amount allowed under the Code as a depreciation expense or an expense in lieu of depreciation for a utility plant acquired by the company with customer surcharges, to the extent the plant is included in the company's rate base at zero cost. The act also allows a natural gas company to deduct natural gas expansion surcharges from its gross receipts before determining its franchise tax liability; natural gas companies pay franchise tax at a rate of 3.22% of total gross receipts. Lastly, the act allows a natural gas company to deduct the surcharges from its gross receipts before determining its sales tax liability, which is 3% of the gross receipts derived from sales of piped natural gas.

The act became effective upon ratification, July 8, 1991. The act does not decrease current General Fund revenues because the surcharges do not currently exist.

1991 Chapter 613 (House Bill 544, Rep. Brawley)

AN ACT CREATING CIVIL PENALTIES FOR BUYING OR SELLING NON-TAX-PAID FUEL.

This act, requested by the Department of Revenue, imposes civil penalties for buying or selling non-tax-paid motor fuel or special fuel for use in motor vehicles. Effective October 1, 1991, a person who dispenses non-tax-paid fuel or allows non-tax-paid fuel to be dispensed into a motor vehicle is subject to a penalty. If the amount of fuel dispensed is less than 25 gallons, the penalty is $75.00. If the amount dispensed is 25 or more but less than 50 gallons, the penalty is $150.00. If the amount dispensed is 50 gallons or more, the penalty is $300.00. In addition, this act provides that failure to pay the penalty is grounds to withhold or revoke the registration plate of the motor vehicle into which the non-tax-paid fuel was dispensed. The penalties collected will be credited to the Highway Fund.

The per-gallon excise taxes levied by the State on fuel apply to all fuel used to operate motor vehicles. Fuel used for other purposes is not taxable. A person who uses motor fuel for a purpose other than to propel a motor vehicle may obtain a refund of the tax paid on the fuel. A person who uses special fuel, which is primarily diesel fuel, for a purpose other than to propel a motor vehicle may either purchase non-tax-paid fuel from a supplier or, if the fuel used was tax-paid fuel, obtain a refund of the tax paid on the fuel. A recent investigation by the Department of Revenue revealed that a high percentage of supplier-resellers selling non-tax-paid special fuel were allowing individuals to evade the tax by allowing the non-tax-paid fuel to be dispensed into motor vehicles. The Department requested this act to help ensure compliance with the tax.

1991 Chapter 618 (House Bill 933, Rep. Howard)

AN ACT TO REPEAL THE SALES TAX EXEMPTION FOR PRISON CONCESSION SALES.

Effective August 1, 1991, this act repealed the State and local sales and use tax exemption for sales to prison inmates and to on-duty prison guards at concession stands operated by the State prison system within prison confines. These sales will now be subject to the 4¢ State sales tax and the 2¢ local sales taxes. This act is expected to increase General

Fund revenues by approximately $334,000 in the 1991-92 fiscal year and $400,000 in the 1992-93 fiscal year.

1991 Chapter 624 (House Bill 20, Rep. Kerr)

AN ACT TO PROVIDE FOR A MORE EFFICIENT AND EQUITABLE PROCEDURE FOR ASSESSING AND COLLECTING LOCAL AD VALOREM PROPERTY TAXES ON CERTAIN MOTOR VEHICLES.

This act creates a new procedure for collecting property taxes on motor vehicles. It is the product of the combined efforts of representatives from the North Carolina County Commissioner's Association, the North Carolina League of Municipalities, the Division of Motor Vehicles, the North Carolina County Assessors Association, the Department of Revenue, and the Institute of Government. Its purpose is to improve the collection rate for property taxes on motor vehicles and thereby recover the estimated $11.1 million in property tax revenue that was lost each year under the former collection system. Its enactment culminates years of study and failed proposals.

The new collection system created by the act becomes effective January 1, 1993. Under the system, all motor vehicles, except public service company vehicles appraised by the Department of Revenue and manufactured homes, are classified for listing, assessment, and taxation separately from other classes of property. The classified motor vehicles consist of two groups: those that are registered with the Division of Motor Vehicles and those that are not registered with the Division of Motor Vehicles. A vehicle is not registered with the Division either because it is a tractor, an earthmover, or some other type of vehicle that cannot be registered with the Division or it is a car or truck and could be, but for some reason, is not registered with the Division.

VEHICLES THAT ARE REGISTERED

Year-round Procedure

The primary purpose of the act is to change the collection procedure for motor vehicles that are registered with the Division of Motor Vehicles. Under the act, registered motor vehicles are taxed on a revolving, year-round basis. To accomplish this, the act requires the Division of Motor Vehicles to give each county a monthly list of all the motor vehicles in the county for which registration was renewed or obtained two months earlier (Section 5, G.S. 20-50.4). The county will then list and appraise the vehicles and send the owners of the vehicles a bill for the county, municipal, and special district property taxes due (Section 1, G.S. 105-330.3(a); G.S. 105-330.5(a)).

How Tax Is Computed

The date the value of the vehicle is determined is the same as before, but the date that ownership, situs, and taxability of the vehicle is determined is different. The value of the motor vehicle is determined as of January 1 preceding the date a new registration is applied for or the current registration is renewed (Section 1, G.S. 105-330.2(a)). The ownership, situs, and taxability of the motor vehicle is determined as of the day the registration is applied for or renewed (Section 1, G.S. 105-330.2(a)).

For a vehicle whose registration is renewed, the amount of property tax due on the vehicle is the value of the vehicle multiplied by the applicable property tax rates in effect on the first day of the month in which the registration of the vehicle would have expired if it had

not been renewed. For a vehicle registered for the first time by the vehicle's owner, the amount of property tax due on the vehicle is the value of the vehicle multiplied by the applicable property tax rates in effect on the first day of the month in which the vehicle is registered. (Section 1, G.S. 105-330.2 and 105-330.5(a)).

Payment of Tax

Taxes on registered motor vehicles are due four months after the registration is obtained or renewed (Section 1, G.S. 105-330.4(a)). A motor vehicle owner who does not pay the taxes is liable for interest at the rate of 3/4% per month (Section 1, G.S. 105-330.4(b)).

If the taxes on a registered vehicle are not paid within four months after they become due, the county includes the motor vehicle on a list that is sent to the Division of Motor Vehicles (Section 1, G.S. 105-330.7). The Division then refuses to renew the vehicle's registration the following year unless the taxpayer obtains a receipt showing that the previous year's taxes have been paid (Section 5, G.S. 20-50.4). Unpaid taxes may also be collected by levying on the motor vehicle or other personal property of the owner, but, unlike under former law, they do not become a lien on the owner's real property (Section 1, G.S. 105-330.4(c)).

For registered motor vehicles, the tax year runs from the first month after the registration is obtained or renewed. The bill provides that the forms necessary to implement this system will begin being used on January 1, 1993.

Transfer of Plates

If an owner transfers the registration plates from one registered vehicle to another, the second vehicle is not taxed until the end of the first vehicle's tax year (Section 1, G.S. 105-330.6). The taxes must be paid on the first vehicle, however, before the registration can be renewed for the second vehicle (Section 5, G.S. 20-50.4).

Registration Not Renewed

If a taxpayer does not renew a motor vehicle's registration, the taxpayer must list the vehicle for taxes by filing an abstract with the assessor of the county in which the vehicle is located on or before January 31 following the date the registration expires (Section 1, G.S. 105-330.3(a)(2)). The vehicle is then taxed as an unregistered vehicle.

Vehicle Tags Surrendered

If a taxpayer surrenders a vehicle's tags and registration before the end of the vehicle's tax year, the taxpayer can obtain a release or refund of the rest of that year's taxes (Section 1, G.S. 105-330.6). The amount is prorated based on the number of full months remaining the vehicle's tax year.

VEHICLES THAT ARE NOT REGISTERED

Under the system, a motor vehicle that is not registered with the Division of Motor Vehicles, either because the Division does not register that type of vehicle or the vehicle owner chooses not to register the vehicle, or a motor vehicle whose registration is not renewed when it expires will continue to be taxed in the same manner. As before, the value, ownership, situs, and taxability of the motor vehicle is determined on January 1 of the year in which the motor vehicle is required to be listed (Section 1, G.S. 105-330.5(b)); the owner must list the motor vehicle by January 31 (Section 1, G.S. 105-330.3(a)(2)); the assessor must prepare a tax notice by the following September 1 (Section 1, G.S. 105-330.5(b)); the county, municipal, and special district tax rates are the rates in effect on July 1 of the year in which the vehicle is required to be listed

(Section 1, G.S. 105-330.5(b)); and the taxes become due on September 1 following the January 31 listing (Section 1, G.S. 105-330.4(a)).

The only difference for these vehicles under the system created by this act concerns liens. Under this act, Section 1, G.S. 105-330.4(c), the tax due on one of these vehicles is not a lien on the real property of the owner of the vehicle. Under current law, the property tax due on any motor vehicle is a lien on the real property of the owner of the vehicle.

CONFORMING CHANGES

Sections 2 through 8 of the act make conforming changes to various statutes to eliminate potential conflicts and confusion and repeal provisions that are no longer needed. Section 2 exempts classified motor vehicles from the listing, appraising, and assessing provisions of Article 22 of Chapter 105 of the General Statutes. This section is necessary to avoid a conflict between Article 22 and new Article 22A. Classified motor vehicles are listed, appraised, and assessed under new Article 22A instead of Article 22.

Section 3 gives the board of county commissioners the discretion to relieve the tax collector from the charge of taxes on classified motor vehicles that are one year or more past due when it appears the taxes are uncollectible.

Section 4 repeals G.S. 20-50.2, which requires an applicant for vehicle registration to certify that the property taxes have been paid on the vehicle and that the vehicle has been listed for property taxes. This provision is not necessary under the system established by this act.

Section 5 adds two new sections to Chapter 20 of the General Statutes. The first section requires the Division of Motor Vehicles to send a list of vehicles for which registration has been renewed or obtained to each county assessor. The second section requires the Division to refuse to renew a vehicle's registration the following year if the Division has received a list from the tax collector indicating that the taxes on the vehicle have not been paid.

When the Division is notified that taxes for a vehicle have not been paid, the Division will send a notice to the taxpayer, with the notice of registration renewal, stating that the Division will refuse registration of the vehicle unless the taxpayer obtains a receipt showing that the previous year's taxes have been paid. If the owner has transferred the tags to another vehicle, the Division will refuse registration of the second vehicle until the owner presents a paid tax receipt identifying the vehicle from which the plates were transferred. The Division, however, cannot refuse to register a vehicle for a person, not named in the list, to whom a vehicle named in the list has been transferred in good faith.

Section 6 deletes the provision in G.S. 20-66(d) that allows a person to register and purchase a license plate for a two-year period. The system established by this act could not work if registration plates were issued for two years instead of one year.

Section 7 clarifies that a taxpayer may request the Division of Motor Vehicles to consolidate the taxpayer's motor vehicle registration dates so that all the vehicles have the same due date. This will ensure that the taxpayer receives only one tax bill annually for the property taxes due on the motor vehicles.

Section 8 repeals the additional $100.00 penalty for failure to list a motor vehicle. The penalty was imposed to encourage more people to list their motor vehicles. The penalty is not necessary under the new system because registration of a vehicle is also the listing of the vehicle.

Recommended by the Property Tax Study Commission.

1991 Chapter 637 (House Bill 487, Rep. Anderson)

AN ACT TO AMEND THE LAW ALLOWING TAX CREDITS FOR QUALIFIED BUSINESS INVESTMENTS.

Effective July 11, 1991, this act makes technical and administrative changes to the statutes concerning tax credits for qualified business investments. In general, a qualified business investment is an investment in the stock of a North Carolina business that is registered with the Secretary of State and is a small business venture, is a business that has received a grant from certain State or federal agencies, is an investment company whose primary investments are in either or both of these first two types of businesses, or is a North Carolina Enterprise Corporation.

The act changes the law as follows:

(1) It deletes references to North Carolina Capital Resource Corporations. These corporations do not exist and can no longer be created because the statutes authorizing their creation, Article 2 of Chapter 53A, have expired.

(2) It gives the Secretary of State the authority to adopt administrative rules concerning the annual registration renewal required of the types of businesses whose stock investments are eligible for a tax credit under G.S. 105-163.011, other than the North Carolina Enterprise Corporation, and requires these businesses to comply with the rules.

(3) It makes several clarifying changes concerning financial statements and revenues of a qualified business venture. First, it requires a qualified business venture to file an annual financial statement with the Secretary of State as well as an initial financial statement. Second, it requires that each financial statement show revenues for the preceding year of no more than $5,000,000 for investments in the business to continue to qualify for a tax credit. Third, it requires a qualified business venture to notify the Secretary of State when its annual revenues exceed $5,000,000.

(4) It changes the tax credit forfeiture provisions in two ways to avoid unintended results. First, it provides that a taxpayer does not forfeit a credit received for investing in a qualified business venture before the annual revenue of the business exceeded $5,000,000. Prior law required a taxpayer who received a credit in any of the three years before revenues exceeded $5,000,000 to forfeit the credit and pay tax. Second, it provides that a taxpayer does not forfeit a credit received for investing in a qualified grantee business if the business does not receive a grant at least every three years. Prior law required a taxpayer who received a credit to forfeit the credit if the business does not receive another grant in the next three years.

The act does not change the amount of an investment credit allowed. For a corporation, the credit is 25% of the amount invested or $750,000, whichever is less. A corporation may apply the credit against its income tax, franchise tax, or premiums gross receipts tax. For an individual, the credit is 25% of the amount invested or $100,000, whichever is less. An individual may apply the credit against the individual's income tax liability. A tax credit is taken for the taxable year beginning in the calendar year following the calendar year in which an investment is made. A credit cannot exceed the amount of taxes imposed; the amount of any unused credit may be carried forward for the next five succeeding years.

1991 Chapter 652 (House Bill 86, Rep. James)

AN ACT TO AUTHORIZE CITIES AND COUNTIES TO IMPOSE AN AVAILABILITY FEE FOR SOLID WASTE DISPOSAL FACILITIES AND TO BILL AND COLLECT THE FEE IN THE SAME MANNER AS PROPERTY TAXES.

This act provides uniform, Statewide authorization for counties and municipalities to levy availability fees for solid waste disposal facilities and to collect the fees in the same manner as property taxes. G.S. 160A-192, 160A-311, and 160A-314 authorize municipalities to impose fees for solid waste collection and disposal. G.S. 153A-292 authorizes counties to impose fees for solid waste collection and for the use of solid waste disposal facilities. In 1989 and 1990, a series of local laws was enacted authorizing certain counties and one municipality to bill and collect these solid waste fees in the same manner as local property taxes. Most of these laws applicable to counties were codified as G.S. 153A-293.

Effective upon ratification, July 12, 1991, this act clarifies the authority of local governments to impose fees for different types of solid waste services and authorizes all counties and municipalities to collect the fees in the same manner as property taxes. Section 1 amends G.S. 153A-292 to provide that a county may levy (i) a fee for collection of solid waste, (ii) a fee for the use of a disposal facility provided by the county, and (iii) a fee for the availability of a disposal facility provided by the county.

There are several limitations on these fees. The collection fee may not exceed the cost of collection. The facility use fee may not exceed the cost of operating the facility and may be imposed only on those who use the facility. The facility use fee may not be imposed on a municipality or its residents unless the fee is based on a schedule that applies uniformly throughout the county. The facility availability fee may not exceed the cost of providing the facility and may be imposed on all improved property that benefits from the facility. The facility availability fee may not be charged in addition to a collection fee that includes the cost of disposal in the available facility.

Section 2 authorizes counties to provide that fees imposed pursuant to G.S. 153A-292 may be billed and collected in the same manner as property taxes. The county may provide that the fees are a lien on the real property for which they are assessed. Section 3 provides a conforming technical change.

Sections 4 and 5 provide that, in addition to the solid waste collection fees and facility use fees it is already authorized to impose, a municipality may impose a fee for the availability of a disposal facility provided by the municipality. The same limitations that apply to a county facility availability fee apply to a municipal facility availability fee. Like a county, a municipality may provide that the availability fees will be billed and collected in the same manner as property taxes and that the fees will be a lien on the real property for which they are assessed. Section 6 repeals the various local acts that formerly applied to specific local governments.

1991 Chapter 666 (House Bill 80, Rep. Lineberry)

AN ACT TO AUTHORIZE A REGIONAL TRANSPORTATION AUTHORITY TO LEVY A VEHICLE REGISTRATION TAX.

This act authorizes a Regional Public Transportation Authority to levy an annual vehicle registration tax not to exceed $5.00 per vehicle. The General Assembly enacted legislation in

1989 authorizing the creation of an Authority in any area of the State between three counties that meet certain criteria. At this time, only Wake, Durham, and Orange counties meet the specifications. In accordance with the 1989 legislation, these counties have formed an Authority to enhance mobility in and between the three counties through an efficient, economical, and environmentally sound public transportation system.

Although the 1989 legislation gave an Authority the power to collect taxes it is authorized to levy, it did not authorize an Authority to levy any kind of tax. This act gives an Authority the power to levy a vehicle registration tax. The Authority may adopt a resolution imposing the tax only after it has held a public hearing on the levy and received a resolution approving the levy from the special tax board of the Authority as well as the board of county commissioners of each county organizing the Authority. The resolution must set the effective date of the levy, which cannot be earlier than the first day of the third calendar month after the adoption of the resolution.

The tax will be collected by the Division of Motor Vehicles at the time a person registers a motor vehicle or renews a motor vehicle's registration. The vehicles listed for property taxes in the counties organizing the Authority are subject to the tax. The Division shall credit the money collected from the vehicle registration tax to a special fund. The net proceeds in the fund will be disbursed quarterly to the Authority. The interest credited to the fund will be disbursed quarterly to the Highway Fund to reimburse the Division for the costs of collecting and administering the tax. An Authority may not spend more than 2% of the money it receives from the tax proceeds for administrative expenses.

1991 Chapter 674 (House Bill 547, Rep. Miller)

AN ACT TO PROVIDE FOR PAYMENT OF EXCESS DAMAGES AGAINST A STATE EMPLOYEE FOR COLLECTING OR ADMINISTERING AN UNCONSTITUTIONAL TAX.

This act authorizes the State to indemnify a State employee who has been held liable for damages for collecting or administering an unconstitutional tax. The act became effective upon ratification, July 13, 1991. The Department of Revenue requested its enactment because of a court case brought the State and the former Secretary of Revenue, Helen Powers.

Section 1 requires the State, in a case in which the State is defending a State employee, to pay the excess amount of a judgment or settlement against the State employee for collecting or administering a tax that is held unconstitutional. The excess amount is the amount above the existing $100,000 protection and any insurance coverage over that limit. Section 2 reorganizes and clarifies the existing law that provides for payment of judgments and settlements up to the $100,000 limit. Section 3 clarifies that the new statute provides protection only for amounts in excess of the insurance coverage provided by the Public Officers and Employees Liability Insurance Commission.

The act does not provide a source of funds to pay an award. If a multi-million dollar award is made against a State employee in a case to which the act applies, the State is legally responsible. The State is protected, however, against having to pay damages that arise from an employee's egregious behavior. The State can decline to become responsible for a case if the Attorney General determines that, because of the employee's behavior or for another reason, it is not in the best interest of the State to do so.

Several lawsuits were filed against the State as a result of the 1989 United States Supreme Court case, Davis v. Michigan, which held that a State cannot give its own employees

or retirees more favorable tax treatment than it gives federal employees or retirees. In response to this decision, in 1989, North Carolina repealed its income tax exemption for State and local retirement benefits and enacted a law that allowed only a limited exemption for all retirees. State and local retirees filed suit challenging that new law. In addition, because of the timing of the Supreme Court case, a number of federal retirees did not receive refunds for taxes paid on their retirement benefits in 1989 and earlier years. Federal retirees filed two lawsuits seeking relief, one in State court and one in federal court. In the federal case, Swanson v. Powers, the lower court decision stated that the Secretary of Revenue could be held personally liable for damages for administering the type of law that was found unconstitutional in Davis v. Michigan. The court found that the damages could be assessed on the theory that the Secretary should have known before Davis v. Michigan was decided that North Carolina's law would be held unconstitutional; therefore, when she administered the law, she was intentionally violating the constitutional rights of some taxpayers. The State cannot be held liable for these damages because of its sovereign immunity.

The Swanson case was reversed on appeal, but its underlying theory caused concern. There are many types of taxes which raise constitutional questions that have never been resolved. As the Davis case illustrates, a new court ruling can invalidate a law that has been on the books and accepted by constitutional scholars for many years. Constitutional law is subtle and complex and is constantly evolving over time. Under the lower court's theory in the Swanson case, if the State chooses to enact a tax that raises an unresolved point of constitutional law, the Secretary and other tax officials are forced to choose between putting themselves at risk for damages of millions of dollars or refusing to perform their legal duty to administer the tax.

Under existing law, the State may indemnify a State employee for up to $100,000 in damages awarded in a judgment or settlement in a civil or criminal action relating to the scope and course of the employee's employment. This protection, provided in Article 31A of Chapter 143 of the General Statutes, is similar to protection under the Tort Claims Act. If the Attorney General determines that it is in the State's best interest to defend a State employee, the State will provide a defense and will pay the damages up to the $100,000 limit. In addition, the State has professional liability insurance for excess coverage of up to $1,000,000 in certain cases. This insurance is obtained by the Public Officers and Employees Liability Insurance Commission in the Department of Insurance.

This coverage protects State employees in many cases but, due to the $1,000,000 limit, it would not be enough to pay the potential multi-million dollar award in Swanson or another case challenging the constitutionality of a tax law. This act goes further and protects tax officials from any potential liability as a result of administering the laws that the State asks them to administer.

Recommended by the Revenue Laws Study Committee.

1991 Chapter 689 (House Bill 83, Rep. Nesbitt)

AN ACT TO MAKE BASE BUDGET AND EXPANSION BUDGET APPROPRIATIONS FOR CURRENT OPERATIONS OF STATE DEPARTMENTS, INSTITUTIONS, AND AGENCIES; TO MAKE APPROPRIATIONS FOR CAPITAL IMPROVEMENTS FOR STATE DEPARTMENT,

INSTITUTIONS, AND AGENCIES; TO MAKE APPROPRIATIONS FOR OTHER PURPOSES; TO PROVIDE FOR BUDGET REFORM; AND TO PROVIDE FOR REVENUE RECONCILIATION.

This act is the Appropriations and Budget Revenue Act of 1991. Title IV (Parts 46 - 56) contains most of the revenue provisions of the act. A few other revenue provisions are found throughout the act. Those provisions are summarized at the end of the explanation of Title IV of the act.

PART 46. INTERNAL REVENUE CODE UPDATE

Part 46 of Chapter 689 rewrites the definition of the Internal Revenue Code used in State tax statutes to change the reference date from January 1, 1990, to January 1, 1991. Updating the reference makes recent amendments to the Internal Revenue Code applicable to the State to the extent that State tax law previously tracked federal law. This update has the greatest effect on State corporate and individual income taxes because these taxes are based on federal taxable income and are therefore closely tied to federal law. The inheritance tax, franchise tax, and intangibles tax also determine some exemptions based on the provisions of the Code.

Since the State corporate income tax was changed to a percentage of federal taxable income in 1967, the reference date to the Internal Revenue Code has been updated periodically. In discussing bills to update the Code reference, the question frequently arises as to why the statutes refer to the Code as it existed on a particular date instead of referring to the Code and any future amendments to it, thereby eliminating the necessity of periodic updates. The answer to the question lies in both a policy decision and a potential legal restraint.

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

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

A number of changes made by the Revenue Reconciliation Act of 1990 will affect the State corporate and individual income tax. The changes in corporate tax law are fairly minor and will not have a significant impact on State revenues.

The State individual income tax will not be affected by the 1990 changes in the federal tax rate structure; these changes include an increase in the maximum federal tax rate to 31%, a lower federal rate for capital gains, and an increase in the federal alternative minimum tax rate. Recent changes in the calculation of federal taxable income will, however, have a significant impact on North Carolina individual income tax. Beginning with the 1991 tax year, the Internal Revenue Code provides that the deduction for personal exemptions is phased out for taxpayers with adjusted gross income above a threshold amount. The threshold amounts are $150,000 for married couples filing jointly and $100,000 for single taxpayers. The personal

exemptions must be reduced by 2% for every $2,500, or fraction thereof, by which the taxpayer's income exceeds the threshold. The personal exemptions are fully phased-out by the time a married couple's income reaches $272,500 and a single taxpayer's income reaches $222,500.

During the House debate on this legislation, the question arose of whether using federal taxable income, that may include only part or even none of the personal exemption deduction, to calculate State taxable income violates the North Carolina Constitution. The General Assembly concluded that it did not. Article V, 2(6) of the North Carolina Constitution states: "The rate of tax on incomes shall not in any case exceed ten percent, and there shall be allowed personal exemptions and deductions so that only net incomes are taxed." The question was whether this provision guaranteed each person the same personal exemption in calculating income. Although the Constitution requires only net income to be taxed, it does not define net income. The amount to be subtracted from gross income in calculating net income is left to the discretion of the General Assembly. Under current law, every taxpayer gets to deduct a minimum standard deduction. The vast majority of taxpayers get additional deductions. Therefore, the phase-out of one type of deduction, the federal personal exemption, does not violate the North Carolina Constitution.

Another major change in the Code is the limitation on itemized deductions for high-income taxpayers. Effective beginning with the 1991 tax year, married taxpayers filing jointly must reduce their itemized deductions by 3% of the amount by which their adjusted gross income exceeds $100,000. For married individuals filing separately, the threshold is $50,000. However, a taxpayer's itemized deductions may not be reduced by more than 80%. The reduction in allowable deductions results in an increase in federal taxable income, the basis for North Carolina taxable income.

Two changes in the Code necessitated a technical adjustment to the State tax law. The Revenue Reconciliation Act of 1990 enacted two new tax credits that, if elected by a taxpayer, require the taxpayer to reduce related federal deductions. State tax law does not pick up federal tax credits, but the reduction of the taxpayer's deductions would be passed through for State purposes. A technical correction provided in this part allows the taxpayer the full benefit of otherwise allowable federal deductions in the calculation of North Carolina taxable income when there is no corresponding State tax credit.

The Revenue Reconciliation Act of 1990 contained a number of other changes that affect the individual income tax. These changes include disallowance of a medical expense deduction for cosmetic surgery, extending income exclusions for certain employer-paid benefits, extending a deduction for health insurance costs paid by self-employed individuals, reducing a deduction for costs of making businesses accessible to disabled individuals, and expanding the percentage depletion allowance for oil and gas producing properties.

This Part of the act is effective for taxable years beginning on or after January 1, 1991. It is estimated that the additional State General Fund tax revenue from this Internal Revenue Code update will be at least $10 million per year, beginning with the 1991-92 fiscal year.

PART 47. CORPORATE INCOME TAX CHANGES

Part 47 of Chapter 689 raises the corporate income tax rate from 7% to 7.75%, effective for taxable years beginning on or after January 1, 1991. It also imposes a temporary surtax equal to a stated percentage of the corporation's income tax liability. The percentage rate of the surtax is 4% for taxable years beginning on or after January 1, 1991. The rate is reduced by 1% each taxable year until January 1, 1995, when it will no longer exist. This Part

also updates the definitional statute for the corporate income tax law by defining and clarifying terms currently in use. It is estimated that the amount of revenue gained from the corporate income tax rate increase and the temporary surtax will be $85 million for the 1991-92 fiscal year.

PART 48. CIGARETTE TAX CHANGES

Part 48 of Chapter 689 increases the excise tax on cigarettes from one mill per individual cigarette to two and one-half mills per individual cigarette. This translates into an increase from 2¢ per pack to 5¢ per pack. The increase was effective August 1, 1991, and it is expected to generate $20 million in additional General Fund revenue for the 1991-92 fiscal year.

PART 49. OTHER TOBACCO TAX CHANGES

Part 49 of Chapter 689 imposes an excise tax on tobacco products other than cigarettes at the rate of 2% of the cost price of the products. The cost price is defined as the price paid for the product by the person liable for the tax before any discount, rebate, allowance, or tax imposed by this Part. As with the tax imposed on cigarettes, the following transactions are exempt from the tax imposed by this part: tobacco products sold outside the State, tobacco products sold to the federal government, and sample tobacco products distributed without charge.

The wholesale or retail dealer who first handles tobacco products subject to the tax in this State is liable for the tax. The dealer must remit the tax to the Secretary of Revenue on a monthly basis. The Secretary may require a dealer to obtain a bond in an amount sufficient to protect the State from loss if the dealer fails to pay the taxes due. A dealer who is primarily liable for the tobacco products tax may deduct 4% from the amount of tax to cover losses due to damage to tobacco products, expenses incurred in preparing the records and reports, and the expense of furnishing a bond. A wholesale dealer must obtain a continuing tobacco products license for each place of business and pay a tax of $25 for the license. The retail dealer must also obtain a continuing tobacco products license and pay a tax of $10 for it.

The excise tax on tobacco products other than cigarettes becomes effective January 1, 1992. The estimated amount of revenue from this new tax is $500,000 for the 1991-92 fiscal year.

PART 50. SOFT DRINK TAX ADMINISTRATIVE CHANGES

Part 50 rewrites much of Article 2B of Chapter 105, the Soft Drink Tax Act, to make the law easier to understand, simpler to administer, and more equitable among the groups of taxpayers subject to the tax. This Part makes the following substantive changes effective October 1, 1991; it does not change the soft drink tax rate.

(1) It eliminates payment of the excise tax on soft drinks based on the purchase of stamps and crowns. Existing law allows but does not require payment based on stamps and crowns; this method is used infrequently.

(2) It establishes a uniform monthly reporting method for payment of the excise tax by distributors, wholesale dealers, and retail dealers. Existing law allows but does not require payment of tax based on monthly reports. The new law does not change the time allowed for filing a monthly report.

(3) It establishes a uniform 4% discount, allows the discount only if the tax is paid on time, and does not allow a discount on bottled soft drinks subject to tax at a reduced

rate. The 4% discount is the same percentage discount as is allowed under the alcoholic beverage excise tax.

Under existing law, the discount varies with the method of payment, can be claimed whether or not the tax is timely paid, and applies both to bottled soft drinks taxable at the regular rate of 1¢ per bottle and to bottled soft drinks taxable at the reduced rate of 1/2¢ a bottle. This reduced rate applies to the first 15,000 gross of bottled soft drinks sold at wholesale each year by each distributor and wholesaler.

(4) It establishes a procedure for identifying soft drinks that are exempt from tax because they will ultimately be sold outside the State or to the federal government. By this procedure, a distributor or wholesale dealer who sells an otherwise taxable item that is to be resold outside the State or to the federal government can sell the item without collecting tax on it if the purchaser gives the distributor or wholesale dealer a written statement certifying that the item will be resold in a non-taxable transaction.

Under existing law, tax is collected whenever a bottled soft drink or base product is sold. If a distributor or wholesale dealer sells to a person who resells the item outside the State or to the federal government, the person notifies the distributor. The distributor then gives the person a credit on the next tax the distributor collects when selling a bottled soft drink or base product to the person, and the distributor applies to the Department of Revenue for a refund. The new procedure will be simpler and less time consuming.

(5) It replaces the exemption for soft drinks that contain at least 35% natural fruit or vegetable juice and have no artificial flavoring, coloring, or preservative with an exemption for soft drinks that are 100% natural fruit or vegetable juice. Under existing law, there were over 500 exemptions for soft drinks that contain at least 35% juice but less than 100% juice. The new law eliminates the exemption for these items. Elimination of the exemption will save time for the Department of Revenue because it will no longer have to register each of these items and periodically check the formula of the item to ensure that it is still tax-exempt.

(6) It deletes the exemption for soft drink base products that are for domestic as opposed to commercial use and are not otherwise exempt from tax.

In addition to these substantive changes, Part 50 makes numerous technical changes. It deletes unnecessary or obsolete language and makes various clarifying changes. It is estimated that this act will generate approximately $500,000 in the 1991-92 fiscal year and $800,000 in the 1992-93 fiscal year.

Recommended by the Revenue Laws Study Committee.

PART 51. INSURANCE TAX CHANGES AND REGULATORY CHARGE

This Part makes several changes concerning the taxation and regulation of insurance companies. The changes are designed to increase revenue for the General Fund, make the Department of Insurance a receipt-supported agency, and enable insurers to recoup assessments paid by them to provide funds to cover claims against insolvent insurers.

To increase revenue for the General Fund, the Part makes a two-step increase in the insurance gross premiums tax rate. It increases the rate from 1.75% to 1.875% effective for the 1991 tax year and, effective for the 1992 tax year and subsequent years, increases the

tax rate again from 1.875% to 1.90%. The increases are expected to raise General Fund revenue by $3.1 million in fiscal year 1991-92 and by $3.8 million in fiscal year 1992-93.

To make the Department of Insurance receipt-supported and thereby eliminate General Fund support of the Department, the Part imposes a regulatory charge on certain insurance companies. The regulatory charge imposed is similar to the charge imposed on utilities by the North Carolina Utilities Commission.

The charge will be imposed beginning with the 1991 tax year and will be a percentage of an insurer's gross premiums tax liability for a year. For the 1991 year the charge is 6.5% of gross premiums tax liability. For each subsequent year, the amount of the charge will be set by the General Assembly. The charge is due when the gross premiums tax is due; therefore, an insurer that pays the gross premiums tax in installments must also pay the regulatory charge in installments. The 1991 charge is expected to generate $11.9 million.

Because the charge is a percentage of gross premiums tax liability, it does not apply to insurers, such as health maintenance organizations, that are not subject to the gross premiums tax. It also does not apply to hospital, medical, or dental service corporations, such as Blue Cross Blue Shield and Delta Dental Corporation, because these nonprofit corporations are specifically exempted from the charge even though they are subject to the gross premiums tax.

The statutes creating the charge distinguish the charge from a tax. Consequently, the statutes provide that the charge is not to be counted as a tax in determining this State's tax rate on insurance companies for the purpose of calculating an out-of-state insurer's liability for any retaliatory taxes due this State and, conversely, for the purpose of calculating an in-State insurer's liability for retaliatory taxes due another state.

From North Carolina's perspective, retaliatory taxes are taxes payable by an out-of-state insurer whose home state requires North Carolina-based insurers to pay a higher tax to that state than North Carolina requires the out-of-state insurer to pay to this State. If the other state's taxes are higher, the out-of-state insurer must pay tax to this State as if this State had the same tax rate as the other state, and the difference between this State's rate and the other state's rate is called the retaliatory tax.

From the perspective of another state, retaliatory taxes are taxes payable by a North Carolina insurer to a state whose tax is lower than North Carolina's rate. The difference between that state's rate and North Carolina's rate is a retaliatory tax for that state.

To preserve the regulatory charge as a source of operating support for the Department of Insurance, this Part establishes the Department of Insurance Fund and credits to the fund all revenue from the regulatory charge as well as all revenue from fees collected from motor clubs, collections agencies, bail bond sureties and runners, and building code inspectors. Revenue in the Fund can be used only to support the Department of Insurance and does not revert to the General Fund at the end of a fiscal year.

To enable insurers to recoup assessments paid to cover claims against insolvent insurers, this Part allows insurers to claim a tax credit against their gross premiums tax for the amount of assessments paid to the North Carolina Insurance Guaranty Association or the Life and Accident and Health Insurance Guaranty Association. These associations require insurers to pay assessments when revenue is needed to cover claims against insolvent or impaired insurers. Under this Part, an insurer who pays an assessment can take 20% of the amount paid as a tax credit in each of the succeeding five years. Because an insurer is allowed a credit, the Part

repeals a provision that allowed insurers to recoup assessments by increasing premiums. The tax credit is effective with the 1991 tax year.

PART 52. INDIVIDUAL INCOME TAX CHANGES

Part 52 of Chapter 689 adds a third tax rate bracket of 7.75% to the individual income tax rate schedule, effective for taxable years beginning on or after January 1, 1991. The higher tax rate bracket is expected to increase revenue $51 million for the 1991-92 fiscal year. Under prior law, there were only two tax rates-- a 6% rate and a 7% rate. The new third bracket affects higher income taxpayers; the Part does not change the incomes subject to the 6% rate. The new rate schedule is as follows:

Filing Status	Income Bracket	Rate
Married, filing jointly	Up to $21,250	6%
+ Surviving spouses	$21,251 to $100,000	7%
	Over $100,000	7.75%
Heads of households	Up to $17,000	6%
	$17,001 to $80,000	7%
	Over $80,000	7.75%
Unmarried individuals	Up to $12,750	6%
	$12,751 to $60,000	7%
	Over $60,000	7.75%
Married, filing separately	Up to $10,625	6%
	$10,626 to $50,000	7%
	Over $50,000	7.75%

PART 53. ALCOHOL TAX CHANGES

Part 53 increases several alcoholic beverage taxes and permit fees and changes the hours during which alcoholic beverages may be sold or consumed. Under prior law, a mixed beverage permittee who purchased spirituous liquor for resale in mixed beverages paid a surcharge of $15.00 per gallon. Of the $15.00 mixed beverage surcharge, $5.00 went to the General Fund, $1.00 went to the Department of Human Resources for substance abuse treatment and education, and $9.00 was distributed to local ABC boards and local governments in the same manner as other alcoholic beverage receipts. Effective August 1, 1991, Part 53 increased the mixed beverage surcharge from $15.00 to $20.00. The additional $5.00 will go to the General Fund; the amounts going to the Department of Human Resources and to local boards and local governments will remain the same.

Effective October 1, 1991, Chapter 565 of the 1991 Session Laws authorizes the sale of spirituous liquor in hotel guest room cabinets. Under that act, a guest room cabinet permittee who purchases spirituous liquor for resale in a guest room cabinet would pay a surcharge of $15.00 per gallon. Part 53 increases the guest room cabinet surcharge from $15.00 to $20.00 to make it the same as the mixed beverage surcharge.

Effective May 1, 1992, Part 53 increases the following ABC permit application fees from $100.00 to $200.00: on-premises malt beverage permits, off-premises malt beverage permits, on-premises unfortified wine permits, off-premises unfortified wine permits, on-premises fortified wine permits, off-premises fortified wine permits, and combined malt beverage or wine permits. Effective May 1, 1992, Part 53 also increases to $100.00 the annual privilege

license taxes for retail malt beverage licenses and retail wine licenses. It is estimated that the tax and fee increases in Part 53 will increase General Fund revenues by $2.9 million in the 1991-92 fiscal year and $6.3 million in the 1992-93 fiscal year.

Finally, effective August 1, 1991, Part 53 expanded the hours during which alcoholic beverages may be sold. Under prior law, sales of alcoholic beverages could be made until 1:00 a.m. and alcoholic beverages could be consumed on-premises until 1:30 a.m. During daylight saving time (April - October), however, sales could be made until 2:00 a.m. and consumption could continue on-premises until 2:30 a.m. Now, the same hours apply all year: alcoholic beverages may be sold until 2:00 a.m. and consumed on-premises until 2:30 a.m.

PART 54. SALES TAX CHANGES

To increase State revenue, this Part increases State sales taxes in two ways. First, it increases the general State sales tax rate from 3% to 4%. Second, it increases the preferential sales tax rate on boats, aircraft, railway cars, and locomotives from 2% to 3%, but does not change the $1,500 maximum per article tax for these items. The changes became effective for sales made on or after July 16, 1991.

The increase in the general sales tax rate is expected to generate $430 million for the General Fund in fiscal year 1991-92 and $516 million for the General Fund in fiscal year 1992-93. The 1% increase in the preferential rate on boats, aircraft, railway cars, and locomotives is expected to generate $2 million for the General Fund in fiscal year 1991-92 and $2.1 million for the General Fund in fiscal year 1992-93.

PART 55. HIGHWAY TAX CHANGES

Part 55 makes several changes that affect revenue in the Highway Fund and the Highway Trust Fund. It transfers funds from the Highway Fund to the General Fund to offset the General Fund loss due to the Department of Transportation's sales tax exemption, exempts several types of vehicle transfers from the highway use tax, increases the highway use tax on out-of-State vehicles, and raises fees collected by the Division of Motor Vehicles.

Since 1986, sales to the Department of Transportation have been exempt from State and local sales and use taxes. Sales to most other State entities are not exempt. Because the Department of Transportation uses Highway Fund money to make purchases, and because State sales and use tax proceeds are credited to the General Fund, the effect of the Department of Transportation's exemption is to increase the Highway Fund at the expense of the General Fund. Earlier versions of House Bill 83 had proposed repeal of the Department of Transportation's tax exemption. In lieu of a repeal, the final version of the bill provides for a quarterly transfer from the Highway Fund to the General Fund of the amount of revenue lost by the General Fund due to the sales tax exemption.

The transfers begin in the 1991-92 fiscal year. For fiscal year 1991-92, $8.7 million will be transferred from the Highway Fund to the General Fund, and $9.4 million is expected to be transferred in fiscal year 1992-93. The transfers have the same fiscal effect on the State as repealing the tax exemption, but do not place on the Department of Transportation the administrative and accounting burden it predicted would result from repeal of the exemption.

Part 55 exempts certain transfers from the highway use tax effective August 1, 1991, as recommended by the Revenue Laws Study Committee. The highway use tax is the 3%, $1,000 maximum motor vehicle titling tax enacted in 1989 to help fund the Highway Trust Fund. The General Assembly created the Highway Trust Fund in 1989 to provide a separate source of funds for a $9.1 billion highway program. To provide additional revenue for the Fund, in 1989

the General Assembly increased the motor fuels tax, increased the fee for issuing a certificate of title from $5.00 to $35.00, and increased related motor vehicle title and registration fees from varying amounts to $10.00.

Unlike the former sales tax on motor vehicles, which was payable only when a motor vehicle was sold, the highway use tax is payable every time a certificate of title is issued for a motor vehicle. A title is issued every time a motor vehicle is transferred to a new owner regardless whether any cash changes hands in the transfer. A new title is also issued if the owner's name, as shown on the title, needs to be changed or corrected. Part 55 reflects the General Assembly's determination that the following motor vehicles, which were formerly subject to the minimum highway use tax of $40.00, should be exempt from the tax:

(1) Vehicles transferred as a result of the death of the former owner.

(2) Vehicles transferred as result of a conveyance between a wife and husband or a parent and child.

(3) Vehicles transferred in a distribution of marital property as a result of a divorce.

(4) Vehicles for which a new title is issued to reflect a change or correction in the owner's name.

Part 55 also increases from $100.00 to $150.00 the maximum highway use tax that applies when a title is issued for a vehicle that has been titled in another state. This increase became effective August 1, 1991.

Finally, Part 55 increases and makes technical corrections to a series of fees and civil penalties paid to the Division of Motor Vehicles. The increases will generate revenue for the Highway Fund and the Highway Trust Fund to help offset the revenue-reducing provisions of Part 55. The fee and penalty increases are as follows:

FEE OR CIVIL PENALTY	**INCREASE**	
	FROM	**TO**
Learner's Permit	$5.00	$10.00
Limited Learners Permit	$5.00	$10.00
Duplicate Drivers License	$5.00	$10.00
Special Identification Card	$5.00	$10.00
Extract of Drivers License Record	$4.00	$ 5.00
Certified Copies of Drivers License Record	$4.00	$ 5.00
Penalty for Owner's Failure to Obtain Timely Title	$4.00	$..5.00
Penalty for Dealer's Failure to Obtain Timely Title		$10.00 New Fee
Overweight Permit, Single Trip	$5.00	$10.00
Overweight Permit, Annual Per Vehicle 1 – 50 Vehicles Next 50 Additional Vehicles	 $25.00 $20.00	 $50.00 $40.00

Next 50 Additional Vehicles Any Additional Vehicles	$15.00 $10.00	$30.00 $20.00
Vehicle Dealer/Distributor's License	$30.00	$50.00
Vehicle Manufacturer's License	$75.00	$100.00
Vehicle Manufacturer's License for Each Factory Branch	$45.00	$70.00
Vehicle Sales Representative's License	$5.00	$10.00
Reissuance of Representative's License to Reflect Employer Name Change	New Fee	$5.00 from 10-01-1991 until 06-30-1992; thereafter, ½ of fee for original license.

These fee and penalty increases became effective August 1, 1991, except that the increases in the fees for annual licenses for vehicle dealers, distributors, and others, become effective July 1, 1992, and the fee for renewal of these licenses to reflect a new employer name becomes effective October 1, 1991.

The fee and penalty increases will generate approximately $10 million annually. The net effect of all the changes made by Part 55 will be an annual gain of $350,000 for the Highway Trust Fund and no gain or loss for the Highway Fund.

PART 56. CONVEYANCE TAX CHANGES

Article 8E of Chapter 105 of the General Statutes levies an excise tax on instruments transferring real property. The tax is known as the deed stamp tax and is collected by the register of deeds of the county in which the real property is located when the deed transferring the property is recorded. This Part changes three aspects of that tax-- the tax rate, computation of the tax, and distribution of the tax revenue.

The Part increases the tax rate from 50¢ for each $500.00 (0.1%) of the value of the property conveyed, less the value of any assumed lien, to $1.00 for each $500.00 (0.2%) of the value of the property conveyed, including the value of any assumed lien. Thus, the Part doubles the tax rate and eliminates the deduction for assumed liens in computing the amount of tax due. The increase is expected to generate $11.9 million for fiscal year 1991-92 and $13.9 million for fiscal year 1992-93.

In addition, the Part directs each county to remit one-half of the net proceeds of the tax to the Department of Revenue, which will credit 15% of the amount received to the Recreation and Natural Heritage Trust Fund, established under G.S. 113-77.7, and will credit the remaining 85% of the amount received to the General Fund. Under prior law, all the proceeds of the tax were retained by the counties.

The Part became effective August 1, 1991, and applies to transfers made on or after that date. A transfer is made when a deed is properly executed, and not when a deed is recorded. Thus, the changes do not apply to deeds executed before August 1, 1991, but recorded after that date.

MISCELLANEOUS REVENUE PROVISIONS

The appropriations provisions of the Appropriations and Budget Revenue Act of 1991 made several changes in the tax laws. The provisions require the cost of the Local Government Commission to be borne by local governments, exempt motor fuel sold for State vehicles from the per gallon excise tax, "freeze" local government reimbursements at their 1990 level, and allow State agencies to receive a refund of local sales and use taxes.

Local Government Commission Funding

Section 24 of this act provides that the cost of the Local Government Commission in the Department of State Treasurer will be paid from the proceeds of the intangibles tax, effective July 1, 1991. Until this change, the Local Government Commission had been funded by annual appropriations from the General Fund. The Local Government Commission performs services for local governments, as provided in the Local Government Finance Act, Chapter 159 of the General Statutes. Several other State programs that provide assistance to local governments are already paid for out of intangibles tax revenue, which is distributed to local governments. These programs are:

(1) Collection of the intangibles tax by the Department of Revenue.

(2) Services performed by the Department of Revenue and the Property Tax Commission in connection with local property taxes.

(3) Training programs operated by the Institute of Government in property tax appraisal and assessment.

Section 24 adds the cost of the Local Government Commission to the list of programs funded from intangibles tax revenue. This change will create an annual saving of approximately $1,047,000 for the General Fund.

State Fuel Tax Exemption

Section 25 of this act provides a fuel tax exemption for motor fuel purchased by the State for use in State-owned vehicles for State business, effective August 1, 1991. Under existing law, the Department of Transportation receives quarterly refunds of motor fuel tax it pays. Other State agencies do not receive fuel tax refunds.

Local Revenue Sharing and Reimbursement Freeze

Section 28 of this act freezes the amount of revenue distributed to local governments under both existing revenue-sharing and reimbursement statutes. As a form of revenue sharing, the State has traditionally distributed to local governments part of the revenue derived from excise taxes on beer and wine and from franchise gross receipts taxes on utility companies, and all the revenue from intangible personal property taxes. In 1990, the laws providing for this revenue sharing with local governments were changed in order to improve the State's balance sheet. The amounts that were formerly earmarked from the tax proceeds and held in a liability reserve for distribution to local governments were credited to the General Fund to be appropriated annually.

This section changes the method for determining how much revenue is to shared. It provides that local governments will share an amount equal to the dollar amount that should have been distributed to them under each statute in the 1990-91 fiscal year and will not receive a fixed percentage of the tax revenues, as formerly designated by statute. Thus, local governments will receive the same amount each year and will not benefit from any growth in revenues from these taxes. The annual distribution will be measured by the amount that should

have been distributed in 1990-91 rather than the amount that was distributed in 1990-91 because the Governor, in order to balance the State budget, withheld some of the distributions that should have been made in the 1990-91 fiscal year.

Local governments also receive annual reimbursements from the State for part or all of their revenue losses due to repeal of the property tax on inventories, repeal of part of the intangibles tax, exemption of food stamp sales from sales tax, and allowance of the property tax homestead exemption. Most of the statutes providing the reimbursement formulas allowed for annual growth in the amount to be reimbursed to reflect the fact that the amount that local governments otherwise would have received from the taxes, had they not been repeal or limited, would have grown each year. Section 28 provides that the amount to be distributed each year will be frozen at the amount that should have been distributed in the 1990-91 fiscal year. The annual distribution will be measured by the amount that should have been distributed in 1990-91 rather than the amount that was distributed in 1990-91 because the Governor, in order to balance the State budget, withheld some of the distributions that should have been made in the 1990-91 fiscal year.

The total amount to be appropriated each year for distribution to local governments pursuant to these revenue-sharing and reimbursement statutes will be frozen at $474,606,174. This freeze reduces the amount that otherwise would have been appropriated from the General Fund by approximately $25 million in the 1991-92 fiscal year and $48 million in the 1992-93 fiscal year.

State Agency Local Sales Tax Refund

Section 190.1 of the act allows a State agency to claim a refund for the amount of local, as opposed to State, sales and use taxes paid by the agency on its direct purchases of property and on its indirect purchases of supplies and fixtures for a building owned or leased by the agency. A "State agency" is any unit of the executive, legislative, or judicial branch of government, including The University of North Carolina but excluding local boards of education.

To enable an agency to claim a refund for tax paid on indirect purchases, the act requires a person who purchases material that becomes part of a building project for an agency to give the agency sufficient information for the agency to determine the amount of refund due the agency. Each State agency is responsible for verifying the accuracy of the information submitted.

The section directs agencies to file claims for a refund within 15 days after the end of each calendar quarter. A late application will be accepted, however, without reduction of the amount of the refund otherwise due. The provision applies to property purchased on or after April 1, 1991.

The purpose of allowing the refund for local sales and use taxes was to generate revenue for the General Fund. The section therefore requires all refunds received by the agencies to be credited to the General Fund. As a result of this provision, the General Fund is expected to receive approximately $14 million in fiscal year 1991-92. The refund provision intentionally targets local sales and use taxes and does not include State sales and use taxes because allowing a refund for State sales and use taxes would not bring any additional revenue to the General Fund. All State sales and use tax revenue is already credited to the General Fund.

Under prior law, a few agencies were granted an exemption from or allowed a refund of both State and local sales and use taxes. The Department of Transportation was exempt and

remains exempt from State and local sales and use taxes on its direct purchases. The amount of revenue, however, that the General Fund loses each year as a result of the Department's exemption from State sales and use taxes is transferred from the Highway Fund to the General Fund under Part 55 of the act.

In addition to the exemption for the Department of Transportation, prior law allowed three agencies to receive refunds of both State and local sales and use taxes. The three agencies are the North Carolina Low-Level Radioactive Waste Management Authority, the North Carolina Hazardous Waste Management Commission, and, for purchases made with contract or grant funds, The University of North Carolina.

1991 Chapter 690 (Senate Bill 108, Sen. Winner)

AN ACT TO IMPROVE ADMINISTRATION OF THE SALES AND USE TAX BY INCREASING THE LICENSE TAXES, ALLOWING MORE SMALL RETAILERS TO FILE QUARTERLY SALES TAX RETURNS, AND EXTENDING THE LIMITATIONS PERIOD FOR ENFORCING LIABILITY AGAINST CERTAIN TRANSFEREES AND CORPORATE OFFICERS, AND TO MAKE TECHNICAL CORRECTIONS TO THE REVENUE LAWS.

This act makes a number of changes to the sales and use tax statutes, as requested by the Department of Revenue, to simplify administration of the taxes. It also modernizes some of the language of the sales and use tax statutes and makes technical changes to reconcile two other statutes with unrelated changes enacted earlier in 1991.

Sections 1, 2, 3, and 5 increase the cost of the privilege licenses that retailers and wholesale merchants must obtain. Effective August 1, 1991, Sections 1 and 3 increase from $5.00 to $15.00 the cost of the one-time privilege license that retailers must obtain before engaging in the retail business. Effective July 1, 1992, Section 2 increases from $10.00 to $25.00 the cost of the annual privilege license that wholesale merchants must obtain. Effective August 1, 1991, Section 5 increases the cost of reissuing one of these licenses if the license is suspended or revoked. For reissuing a retailer license, the cost is increased from $5.00 to $15.00; for reissuing a wholesale merchant license, the cost is increased from $10.00 to $25.00. The purpose of these licenses is to register the merchants with the Sales and Use Tax Division of the Department of Revenue. The cost of the licenses had not been increased in twelve years and was less than the actual administrative cost of issuing and renewing the licenses.

Section 4 authorizes quarterly sales tax filing for more small retailers, effective July 1, 1992. Under existing law, all businesses that owe at least $25.00 in State and local sales taxes each month are required to file monthly returns; businesses that owe less than this amount may file quarterly. Section 4 raises the threshold from $25.00 to $50.00, so that all businesses liable for less than $50.00 a month may file quarterly. This change will simplify sales tax filing for many small businesses.

Sections 1 through 5 of this act will affect General Fund revenues differently in different fiscal years. In the 1991-92 fiscal year, an increase of approximately $360,000 is expected; in the 1992-93 fiscal year, there will be no fiscal impact because the estimated gain of $960,000 due to the increase in the licenses costs will be offset by an estimated one-time loss of the same amount due to the change in the filing threshold; in the 1993-94 fiscal year, an increase of approximately $960,000 is expected.

Effective August 1, 1991, Sections 6 and 7 provide an additional one-year period during which the Department of Revenue may assess unpaid taxes of a retail business against

(i) a person to whom the business has been transferred, (ii) the business property that was transferred, or (iii) a corporate officer who has allowed corporate funds to be disbursed without paying taxes due. This change makes the period relating to retail businesses the same as the period allowed for assessing a person to whom a taxpayer's assets have been transferred.

Under existing law, if a retail business is transferred, the transferor is required to pay all sales and use taxes owed by the business. The taxes are a lien against the transferor's property, including the transferred business property. In addition, in order to protect the State's interest in these taxes, the law requires the transferee to withhold enough of the purchase price to cover the taxes until the transferor shows a receipt or certificate proving that there are no outstanding taxes due from the business. If the transferee fails to do this, and the transferor does not pay the taxes, the transferee is personally liable under existing law for the taxes to the extent of the purchase price paid for the business or the fair market value of the property, whichever is greater.

Section 6 provides that the Department of Revenue may enforce the lien against the property or assess the liability against the transferee for an additional year after the limitations period has expired against the transferor. The Department stated that the additional year is necessary so that the Department may first pursue its remedies against the transferor before proceeding against the transferee. Section 6 also provides that the transferee is personally liable only to the extent of the consideration paid for the business; if the fair market value of the property exceeds the consideration paid, the transferee is not personally liable for the excess amount. The Department of Revenue may proceed against the property to collect the excess amount.

Under existing law, corporate officers are required to pay taxes due to the State before allowing corporate funds to be distributed. If a corporate officer allows the funds to be disbursed without paying the taxes due, the officer becomes personally liable for the taxes. Section 7 provides that the Department of Revenue may assess this liability against the officer for an additional year after the limitations period has expired against the corporation. The Department stated that the additional year is necessary so that the Department may first pursue its remedies against the corporation before proceeding against the officer.

Sections 8, 9, and 10 correct problems created by earlier 1991 legislation. Sections 8 and 9 correct problems created by amendments made in the 1991 Session to the same statute, G.S. 105-159.1. The revenue laws technical correction bill and an election law bill both amended that statute in different ways. These sections make the changes intended by those earlier amendments. Section 10 corrects a cross-reference to the scrap tire tax. A Revenue Laws Study Committee proposal enacted earlier in the 1991 Session recodified the scrap tire tax statutes.

Based on a recommendation of the Revenue Laws Study Committee.

1991 Chapter 708 (Senate Bill 539, Sen. Staton)

AN ACT TO AUTHORIZE THE DEPARTMENT OF REVENUE TO ESTABLISH THE TIME PERIOD FOR STAMPING CIGARETTES.

Effective October 1, 1991, this act repeals the requirement that a distributor must affix tax stamps to cigarettes within 48 hours after receiving the unstamped cigarettes and provides instead that the time within which the stamps must be affixed is to be set by the Secretary. The purpose of the change is to allow for situations in which a distributor purchases such a large

quantity of cigarettes that it cannot stamp them all within 48 hours. The new law will enable the Secretary of Revenue to adopt a rule setting a time limit of 48 hours but providing an exception for unusually large purchases.

1991 Chapter 717 (Senate Bill 263, Sen. Perdue)

AN ACT TO EXTEND THE PROPERTY TAX EXCLUSION FOR HISTORIC PRESERVATION PROPERTY TO INCLUDE LAND HELD AS A SITE TO WHICH AN HISTORIC BUILDING WILL BE MOVED.

Effective July 1, 1991, this act adds another type of property to the list of property that is excluded from property taxes. The act excludes from taxation property that is owned by a nonprofit historic preservation corporation, is located within an historic district created under Part 3A of Article 19 of Chapter 160A of the General Statutes, and is to be the site of an historic structure that is to be moved to the property.

Unlike most exclusions, the exclusion granted by this act is of limited duration and the taxes that would otherwise by payable on the property in the absence of this exclusion are deferred and might become payable. The deferred taxes never become payable if an historic structure is moved to the property, as planned, within five years after the taxes are first deferred. The deferred taxes, plus interest, become payable if an historic structure is not moved to the property within five years after the taxes are first deferred.

Under prior law, property held by a nonprofit historic preservation corporation for use as the future site of an historic structure could not be excluded from property tax because it did not meet the requirement that the property be currently used for historic preservation. Although the property's future use was to be for historic preservation, its current use as vacant land or as property of no historical significance was not considered to be a current historic preservation use.

1991 Chapter 752 (Senate Bill 103, Sen. Winner)

AN ACT TO CLARIFY SUBCHAPTER S CORPORATION LOSS CARRYFORWARDS.

This act clarifies the intent of a 1990 act concerning net economic loss carryforwards by Subchapter S corporations. The 1990 act, Chapter 984 of the 1989 Session Laws (Reg. Sess. 1990), mitigated the effect of the 1989 transition from non-recognition of S corporations under the State income tax law to recognition of these corporations. The 1990 act allowed S corporations to carry forward part of the net economic losses incurred by them during any of the five years before January 1, 1989. During these years, S corporations were taxed as C corporations rather than as individual shareholders.

The 1990 act allowed S corporations to carry net economic losses forward for three years, but limited the amount that could be carried forward to one-half of the amount that could have been carried forward under prior law if the S corporation were taxed as a C corporation. This act resolves questions that arose over the meaning of the one-half limitation. It clarifies that the limitation to one-half of the amount that would have been allowed if the law had not changed applies separately to each of the years to which losses may be carried forward and does not limit the aggregate amount that may be carried forward to one-half of the total pre-1989 net economic losses.

Thus, if an S corporation has a pre-1989 net economic loss of $1,000 that can be carried forward, it is not limited to deducting only $500.00 (half of $1,000), at most, of the loss. How much of the loss it can deduct depends on its income for 1989, 1990, and 1991. If the corporation has enough income in each of those three years to deduct fully the amount it would have been able to deduct if the law had not changed and to meet the separate requirement that the deduction not exceed one-half of the corporation's income for the year in which the deduction is made, the corporation can deduct $500.00 in 1989 (half of $1,000), $250.00 in 1990 (half of the $500.00 that could not be deducted in 1989), and $125.00 in 1991 (half of the $250.00 that it could not deduct in 1989 or 1990).

Recommended by the Revenue Laws Study Committee.

1990

Prepared by: Cynthia Avrette, Sabra J. Faires, and Martha H. Harris

1990 Chapter 813 (House Bill 2377, Rep. Dave Diamont)

AN ACT TO REQUIRE UTILITIES TO PAY CERTAIN TAXES IN FISCAL YEAR 1989-90 THAT WOULD OTHERWISE BE PAYABLE IN FISCAL YEAR 1990-91 AND TO CHANGE THE ACCOUNTING METHOD THAT APPLIES TO REVENUE DISTRIBUTED TO LOCAL GOVERNMENTS FROM CERTAIN TAXES LEVIED BY THE STATE.

Article III, 5 of the North Carolina Constitution requires the State to have a balanced budget. The budget must be balanced on both a cash and budget basis as well as on a financial basis, in accordance with generally accepted accounting principles. The Governor's decision to move the State employees' pay day from June 30, 1990, to July 1, 1990, balanced the 1989-90 budget on a cash and budget basis. This act allowed the budget to be balanced on a financial basis as well by:

(1) Receiving cash in the 1989-90 fiscal year that the State would otherwise have received in the next fiscal year.

(2) Changing what were liability reserves for revenue that is to be distributed to local governments to appropriations from next year's budget.

(3) Shifting certain venture capital investments made from the General Fund and the Highway Fund to special funds, such as the Escheats Fund.

Although this act changed the timing and accounting for certain revenue, it did not generate additional recurring revenue.

Utility companies normally remit sales taxes and pay franchise taxes on a quarterly basis. This act requires utility companies with an accrued sales tax liability or an accrued franchise tax liability for the months of April and May 1990 of at least $2,000 to pay the taxes collected for those months by June 25, 1990. It further requires these utilities to remit taxes that accrue in June 1990 by July 30, 1990. The State receives $58.3 million from these utility tax payments in the 1989-90 fiscal year that it would have otherwise received in the 1990-91 fiscal year. Effective October 1, 1990, Chapter 945 of the 1989 Session Laws, requires most utility companies to begin paying sales taxes and franchise taxes on a monthly basis.

Effective June 21, 1990, excise taxes on beer and wine, franchise gross receipts taxes on utility companies, and taxes on intangible personal property that were reserved for distribution to local governments are credited to the General Fund, subject to annual appropriation to the local governments. This change in liability reserves to appropriations changes the distribution to local governments from an accrual method of accounting to a cash method of accounting. It also had the effect of transferring $140 million in the 1989-90 fiscal year from liability reserves for revenue that is distributed to local governments to appropriations from the 1990-91 budget. Recognizing that the distributions to local governments from these taxes are a traditional revenue source for them, the act states that it is the General Assembly's intent for the appropriations to be continuing appropriations.

Cities receive 3.09% of the gross receipts derived by an electric power company, a natural gas company, or a telephone company from business within the city. The revenue is distributed to the cities on a quarterly basis. Previously, when the utilities paid the gross receipts taxes, the share of the cities was put in a liability reserve account and was not counted as revenue to the State. Under this act, the cities' share is placed in the General Fund and the amount needed to make the quarterly distributions is appropriated from the General Fund in the State budget.

Currently, cities and counties in which the sale of beer and wine is legal receive 23.75% of the excise tax on beer, 62% of the excise tax on unfortified wine, and 22% of the excise tax on fortified wine. Cities and counties receive this revenue within 60 days after September 30 based on collections for the 12-month period ending on September 30. As with the gross receipts tax, the act changes the accounting method for these excise taxes so that the revenue is not put in a reserve account as it is collected but is instead appropriated in the State budget.

Cities and counties also receive most of the intangibles tax revenue collected. They receive their share as soon as practical after the end of the fiscal year based on collections for the fiscal year. The act likewise changes this distribution to an appropriation. The appropriation must be made by August 30 of each year.

Under prior law, the State Treasurer could invest General Fund and Highway Fund money in the North Carolina Enterprise Corporation and in limited partnership interests in partnerships that are managed primarily for the purpose of investment in venture capital firms and corporate buyout transactions. This act shifts these investments from the General Fund and the Highway Fund to special funds, such as the Escheats Fund. This change was made to release $50 million from liability reserves in the General Fund and Highway Fund and to shift long-term investments out of the General Fund and Highway Fund.

1990 Chapter 814 (Senate Bill 1361, Senator Dennis Winner)

AN ACT TO MAKE TECHNICAL CHANGES TO THE REVENUE LAWS.

This act makes numerous technical and conforming changes to the revenue laws. Except as otherwise noted, the provisions of this act are effective upon ratification.

Section 1 deletes a cross-reference to a statute that was repealed in 1988. Section 2 corrects an incorrect cross-reference that was added in 1989 and section 3 corrects an ungrammatical construction.

Effective July 1, 1990, section 4 repeals an obsolete, redundant statute providing for licensure of certain emigrant agents. In practice, all emigrant agent licenses have been issued under G.S. 105-90, which essentially duplicates G.S. 105-90.1. Both the Department of Revenue and the Employment Security Commission confirmed that G.S. 105-90.1 serves no known purpose.

Section 5 deletes a cross-reference to a statute that was repealed in 1989 and corrects a cross-reference to a subsection that was renumbered in 1989.

Sections 6 through 9 make clarifying amendments to the Controlled Substance Tax Act. The first two sections separate criminal and civil penalties for violation of the Act and clarify that interest applies to overdue taxes. The latter two sections clarify that reporting requirements imposed on law enforcement agencies by the Act apply only to arrests where drugs seized are subject to tax.

Sections 10 and 11 delete language in two franchise tax statutes that relates to provisions repealed as obsolete in 1989. Section 12 changes from December 31 to September 30 the cut-off date relating to the return used for computing the proportion of dividends deductible for corporate income tax purposes and the stock value not taxable for intangibles tax purposes. The modification, requested by the Department of Revenue, is needed to enable the Intangibles Tax Division to publish annually the booklet, Stock and Bond Values, in a more complete and timely manner.

Both the corporate and individual income tax allow a credit for construction of a fuel ethanol distillery. In 1987, the bill rewriting these credits was amended at the last minute to extend the sunset date from 1993 to 1994 for the individual income tax credit. Apparently through oversight, the corporate income tax credit sunset was not similarly extended. Section 13 extends the corporate income tax credit sunset date from 1993 to 1994.

Section 14 updates a reference to the former Department of Commerce, now the Department of Economic and Community Development. Section 15 removes "corporation" from the definition of a person under the Individual Income Tax Act. Effective with the 1990 tax year, section 16 authorizes the Secretary of Revenue to issue individual income tax tables, similar to tables issued by the Internal Revenue Service and many other states. This change will simplify tax preparation for North Carolina citizens.

Section 17 makes language changes that were included in a 1989 act but did not take effect due to an error in the coded bill drafting format. Section 18 corrects an incorrect cross-reference added in 1989. Section 19 corrects an ambiguous cross-reference, thus clarifying that the tax rates for single individuals apply to nonresident partners of a North Carolina partnership. Section 20 deletes a stray word that a 1989 law intended to repeal, but due to an error in the coded bill drafting format, did not.

Effective with the 1990 tax year, section 21 corrects the formula for apportioning estate or trust income by providing the appropriate distinction between income that is for the benefit of a resident of this State and income that is for the benefit of a nonresident. Section 22 deletes a reference to a repealed law. Section 23 corrects an erroneous cross-reference to the statutes providing general administration provisions, penalties, and remedies for the Revenue Act.

Sections 24 through 27 amend gift tax, intangibles tax, and gross premiums tax statues to delete cross-references to repealed statutes and substitute appropriate cross-references to preserve the substance of the law. Section 28 clarifies that corporations as well as individuals may elect to apply all or part of their income tax refunds to the following year's tax liability. Section 29 corrects a grammatical error.

Sections 30 through 34 clarify that only the additional fee for vanity plates is credited to the Personalized Registration Plate Fund; the $20.00 registration fee charged for all passenger vehicles continues to go to the Highway Fund. These sections also correct grammar and replace the phrases "deposited in" and "placed in" with the technically correct phrase "credited to."

Recommended by the Revenue Laws Study Committee.

1990 Chapter 848 (Senate Bill 1362, Senator Dennis Winner)

AN ACT TO TREAT INVESTMENTS IN A PARTNERSHIP IN WHICH THE NORTH CAROLINA ENTERPRISE CORPORATION IS THE ONLY GENERAL PARTNER AS AN INVESTMENT IN THE

CORPORATION AND TO EXTEND THE TAX CREDIT FOR INVESTMENTS IN AN ENTERPRISE CORPORATION.

Effective for taxable years beginning on or after January 1, 1990, this act makes two changes in the tax credit allowed in G.S. 105-163.011 for investments in a North Carolina Enterprise Corporation. First, it expands the tax credit to include investments in a limited partnership in which a North Carolina Enterprise Corporation is the only general partner. Second, the act adds gross premiums taxes to the list of taxes for which a tax credit is available as a result of an investment in a North Carolina Enterprise Corporation.

Under prior law, an investment in a North Carolina Enterprise Corporation qualified for a tax credit but an investment in a limited partnership in which a North Carolina Enterprise Corporation was a general partner did not. Also under prior law, a tax credit could be applied to corporate and individual income taxes and corporate franchise taxes but not to gross premiums taxes.

The purposes of the first change are to allow a North Carolina Enterprise Corporation to establish a limited partnership without its investors suffering adverse tax consequences and to allow a North Carolina Enterprise Corporation to reduce its potential corporate income and corporate franchise tax liability by transferring its venture capital and stocks to the limited partnership. As a partner in the limited partnership, a North Carolina Enterprise Corporation would pay taxes on its share of the partnership income but would not have to pay corporate income and franchise taxes on distributions of venture capital income and on its assets. The change reduces a Corporation's potential franchise tax liability by $30,000 and its potential income tax liability by an undetermined amount. To date, the only North Carolina Enterprise Corporation has not distributed any investment income to its shareholders and its income has been limited to interest earned on its invested cash.

The purpose of the second change is to encourage insurance companies to invest in a North Carolina Enterprise Corporation. Under G.S. 105-228.5, insurance companies pay taxes based on their gross premiums instead of paying corporate income and franchise taxes. Under prior law, an insurance company had no incentive to invest in a North Carolina Enterprise Corporation because the insurance company could not benefit from a tax credit against income or franchise taxes. Allowing a credit against gross premiums taxes will have no effect on revenue in fiscal year 1990-91 and will have an effect in future years only to the extent that insurance companies invest in a North Carolina Enterprise Corporation.

A North Carolina Enterprise Corporation is a corporation established under Article 3 of Chapter 53A of the General Statutes to provide venture capital for businesses located primarily in rural North Carolina. Since the General Assembly authorized these corporations in 1988, only one North Carolina Enterprise Corporation has been established. The State is the principal investor in that corporation, named The North Carolina Enterprise Corporation.

G.S. 105-163.011 provides individual and corporate tax credits for investments in a North Carolina Enterprise Corporation. Individuals are allowed a credit against income taxes equal to 25% of the amount invested or $100,000, whichever is smaller. Corporations are allowed a credit against income or franchise taxes equal to 25% of the amount invested or $750,000, whichever is smaller. A credit is taken in the taxable year following the year in which an investment is made. Total tax credits for investments in a North Carolina Enterprise Corporation and several other types of businesses cannot exceed $12,000,000 in any year.

Recommended by the Revenue Laws Study Committee

1990 Chapter 869 (Senate Bill 1496, Senator Russell Walker)

AN ACT TO EXTEND TIME FOR THE RESOLUTION OF CLAIMS TO LAND UNDER NAVIGABLE WATERS.

This act extends by four years the time allowed to resolve claims to land under navigable waters. G.S. 105-151.12 gives a person who donates land to the State that is useful for land conservation purposes a tax credit equal to 25% of the donated property's interest. In the case of marshland for which a claim has been filed, the offer of donation had to be made before December 31, 1990, to qualify for the credit. This act extends the credit to December 31, 1994.

In 1965, the General Assembly established a procedure for the registration and resolution of submerged lands claims. Approximately 3,000 claimants registered about 10,000 claims by the deadline date of January 1, 1970. In 1985, the General Assembly extended the tax credit provided in G.S. 105-151.12 to people who donated marshland to the State for which an interest was claimed. The credit gives citizens some incentive to relinquish their marshland claims and allows the State to regain valuable marshland. The cost to the State of the credit is minimal since the property tax value of marshlands is low. Two donations have been made under this provision to date.

The original legislation set a 21-year deadline for the State to resolve the claims in order to prevent the claims from perfecting by adverse possession. In 1988, the North Carolina Supreme Court ruled that lands under navigable waters cannot be acquired by adverse possession, thus removing the need for the 21-year deadline. Although the Division of Marine Fisheries of the Department of Environment, Health, and Natural Resources has worked diligently to resolve the claims by the 1990 deadline, it finds it cannot because of the complex title issues involved and the length of time it takes to complete each claim.

1990 Chapter 881 (Senate Bill 1354, Senator William Staton)

AN ACT TO REGULATE REFUND ANTICIPATION LOANS.

In 1989, North Carolina became the first state to enact legislation regulating Refund Anticipation Loan (RAL) programs in conjunction with electronically filed tax returns. An RAL program is a program in which a person who has his or her federal income tax return filed electronically by a tax preparer can obtain a loan from a national bank in the amount of the anticipated federal tax refund, less charges for the preparation and filing of the return and for the loan. Refund anticipation loans involving North Carolina income tax refunds are prohibited by G.S. 143-3.3.

This act creates the "Refund Anticipation Loan Act" to become effective October 1, 1990. The act applies to a "facilitator," any person who processes, receives, or accepts an application for a refund anticipation loan or a check in payment of refund anticipation loan proceeds, or who otherwise facilitates such a loan. "Refund Anticipation Loan" is defined as a loan that the lender (bank) arranges to be repaid directly from the proceeds of the borrower's income tax refund.

Under the new law, facilitators of refund anticipation loans are required to register with the Commissioner of Banks and pay a fee of $250.00. Failure to register is a misdemeanor punishable by imprisonment for up to sixty days, a fine of up to $2,000, or both. Registration must be renewed annually; the fee for renewal is $100.00. A facilitator that is a bank, savings

and loan, or credit union is not required to register under this act, because these institutions are already regulated by the Department of Economic and Community Development.

Registrants are required to file a schedule of refund anticipation loan fees with the Commissioner of Banks and post that schedule at each office. If the Commissioner finds the fee schedule to be unconscionable, the Commissioner must notify the registrant.

At the time a person applies for a refund anticipation loan, the registrant must disclose the following information:

1. The fee for the loan;
2. The fee for electronic filing of a tax return;
3. The time within which the proceeds of the loan will be paid if approved;
4. That the debtor is responsible for repayment if the tax refund is not paid;
5. The availability of electronic filing and the average time announced by the appropriate taxing authority in which a taxpayer can expect to receive a refund if the return is filed electronically and the taxpayer does not receive a refund anticipation loan; and
6. Examples of annual percentage rates for average RAL's.

Facilitators of refund anticipation loans are prohibited from engaging in the following activities:

1. Misrepresenting a material factor or condition;
2. Failing to arrange for the loan promptly;
3. Fraud;
4. Charging a fee that is different from the posted fee or is in an amount that the Commissioner has notified the facilitator is unconscionable;
5. Arranging for payment of any portion of the loan for an unrelated service; and
6. Arranging for a lender to take a security interest in property other than the proceeds of the tax refund.

Engaging in a prohibited activity or an unfair or deceptive practice may result in entry of a cease and desist order, revocation of registration, and various civil penalties. Appeals may be taken directly from the Commissioner of Banks to the North Carolina Court of Appeals.

Recommended by the Depository Institutions Study Commission.

1990 Chapter 908 (House Bill 2074, Rep. Dan Lilley)

AN ACT TO INCREASE THE MAXIMUM BOND THAT MAY BE REQUIRED OF FUEL DISTRIBUTORS AND SUPPLIERS.

This act increases the maximum bond that may be required of fuel distributors and suppliers. Distributors of motor fuel are subject to the Gasoline Tax under Article 36 of Chapter 105 of the General Statutes. Distributors must obtain a license from the Department of Revenue and post a bond in the amount required by the Secretary of Revenue, up to a maximum of $40,000. Suppliers of special fuels (primarily diesel fuel) are subject to the Special Fuels Tax under Article 36A of Chapter 105 of the General Statutes. Suppliers must obtain a license from

the Department of Revenue and post a bond equal to three times the supplier's average monthly tax liability, up to a maximum of $40,000. Distributors who are also suppliers may obtain a single bond to cover both taxes, up to a maximum bond of $80,000.

Effective January 1, 1991, the new law increases the maximum bond required of a distributor of motor fuel or a supplier of special fuels to two times the taxpayer's average monthly liability, or $2,000, whichever is greater. For a person who is both a distributor and a supplier, the maximum bond is the total of the two bonds or $4,000, whichever is greater.

Recommended by the Revenue Laws Study Committee.
1990 Chapter 936 (House Bill 2335, Rep. George Miller)

AN ACT TO IMPLEMENT THE JOINT REPORT TO PROVIDE MANAGEMENT INCENTIVES AND FLEXIBILITY FOR THE CONSTITUENT INSTITUTIONS OF THE UNIVERSITY OF NORTH CAROLINA AND TO REQUIRE THE CREATION AND ENHANCEMENT OF A PROGRAM OF PUBLIC SERVICE AND TECHNICAL ASSISTANCE TO THE PUBLIC SCHOOLS.

This act primarily makes changes in the procedures used by the 16 State universities to account for funds appropriated to them. In addition, it raises the competitive bidding threshold and the State purchasing threshold for all agencies from $5,000 to $10,000 and allows the 16 universities to obtain a semiannual sales tax refund for State and local sales and use taxes paid by them on personal property purchased with contract and grant funds, as opposed to funds appropriated to them by the State. The sales tax refund becomes effective January 1, 1992, and applies to sales and use taxes paid on or after that date.

Under prior law, all purchases made by the universities were subject to sales and use taxes and no refund was available. Until recently, the universities and all other State-supported agencies were not allowed an exemption from or a refund for sales and use taxes on the theory that a sales tax exemption or refund creates an administrative problem and does not result in a net revenue gain to the agency. If an agency does not have to pay sales and use taxes, the General Assembly does not need to appropriate money to the agency to cover the taxes and can therefore reduce the appropriation it would otherwise make to the agency. In 1986, the General Assembly departed from this theory and exempted purchases made by the Department of Transportation from sales and use taxes.

Allowing the universities to obtain a refund of sales and use taxes beginning January 1, 1992, will reduce State General Fund revenue and local revenue beginning with the 1992-93 fiscal year by an undetermined amount. Because of the delayed effective date, the refund will obviously have no effect on revenues for the 1990-91 fiscal year. The refund will also have no effect on revenues for the 1991-92 fiscal year because the first semiannual refund period for which a university can claim a refund ends June 30, 1992.

1990 Chapter 945 (Senate Bill 1586, Senator Kenneth Royall)

AN ACT TO ACCELERATE THE PAYMENT OF SALES TAXES AND GROSS RECEIPTS TAXES BY UTILITIES AND TO ACCELERATE THE PAYMENT OF WITHHELD INDIVIDUAL INCOME TAXES BY EMPLOYERS.

This act accelerates the dates on which the following taxes must be paid: sales taxes on utility services, certain franchise taxes on utilities, and income taxes withheld from wages by employers.

Sales taxes on utility services were formerly payable on a quarterly basis by the 30th day after the end of the quarter. Effective October 1, 1990, sections 1 and 2 of this act provide that all utilities, other than telephone companies that make quarterly returns of franchise taxes, must make monthly returns of sales taxes on utility services. A monthly return is due on the last day of the following month, except that the return for May is due June 25. A utility filing on a monthly basis may make estimated returns for the first two months of the quarter and will not be penalized if the amount paid for these months is at least 95% of the amount due.

Franchise taxes on utility companies were formerly payable on a quarterly basis by the 30th day after the end of the quarter. Effective October 1, 1990, sections 3 and 4 of this act require telephone companies that have an average tax liability of $3,000 or more, electric power companies, and natural gas companies to make monthly payments of franchise taxes; reports must be filed each quarter. A monthly payment is due on the last day of the following month, except that the payment for May is due June 25. A utility filing on a monthly basis will not be penalized if the amount paid is at least 95% of the amount due and the balance is paid with the next quarterly report.

The remainder of this act changes the rules governing withholding of income taxes from employees' wages by employers, effective January 1, 1991. Section 5 simplifies definitions relating to withholding and adopts certain federal definitions. Section 6 provides that a member of the clergy will be considered self-employed, and thus not subject to withholding, unless he or she elects to be treated as an employee for purposes of withholding. This change conforms the State law to the federal law.

Sections 7 and 8 provide that the amount withheld shall be the employee's anticipated State income tax liability, estimated based on the exemptions, deductions, and credits to which the employee is entitled. Section 9 makes clarifying changes.

Formerly, transient and seasonal employers and employers withholding an average of $500.00 or more from wages per month were required to make returns and pay withheld taxes on a monthly basis; all other employers paid quarterly. Section 10 now provides that employers who withhold an average of $2,000 or more per month shall pay the withheld taxes on the date set under the Code for depositing or paying federal income taxes withheld from the same wages. Under current federal regulations, that date is usually three banking days after the end of an "eighth-monthly period" if, at that time, the employer has $3,000 or more in undeposited federal taxes. An "eighth-monthly period" is one of eight periods into which each month is divided under the Internal Revenue Code. Federal law also requires an employer to make a deposit one banking day after accumulating $100,000 or more in withheld taxes; Section 10 provides that this requirement does not apply to deposits of North Carolina taxes. Section 10 also provides that an extension of time for filing a return or paying withheld federal taxes is an automatic extension with respect to withheld State taxes. The Secretary is required to notify each employer of the payment schedule it must follow.

Section 11 provides that an annual information report of State income taxes withheld from wages is due on the same date as the federal information return of federal income taxes withheld from wages. Section 12 clarifies the liability of employers and others for amounts required to be withheld from taxes and clarifies the penalty of 25% for an employer's failure to withhold or pay taxes. Section 13 makes clarifying changes. Section 14 provides that the general enforcement and administration provisions of the Revenue Act apply to withholding taxes. Section 15 provides that the Secretary of Revenue may contract with a financial institution for the receipt of withheld income tax payments from employers.

Finally, this act provides that the nonrecurring revenue it generates shall be used to fund only nonrecurring expenses. It is estimated that the changes in withholding payments will generate $110.5 million in nonrecurring revenue in the 1990-91 fiscal year. The changes in payments by utilities make permanent the changes made by Chapter 813 of the 1989 Session Laws; those changes generated nonrecurring revenue of $58.3 million for the 1989-90 fiscal year. The State will realize some recurring revenue from the interest that will be earned on the taxes paid earlier pursuant to this act. This recurring revenue is estimated at $5.3 million for the 1990-91 fiscal year and $8.9 million for the 1991-92 fiscal year.

1990 Chapter 946 (Senate Bill 1587, Senator Bill Barker)

AN ACT TO IMPROVE THE PROCEDURE FOR COLLECTING DEBTS OWED THE STATE BY SETTING OFF THE DEBTS AGAINST TAX REFUNDS.

This act amends the Setoff Debt Collection Act to allow claimant agencies to file an on-going claim for setting off against an individual's State tax refund the amount of any debt owed by the individual to the State. Currently, a claim must be filed each year. Under this act, the claimant agency files a claim with the Department of Revenue stating the date, if any, that the debt is expected to expire. The claim is effective to initiate setoff against refunds of $50 or more that would be made in calendar years following the year in which the claim was first filed until the date the debt expires.

The act is effective July 1, 1990, and applies to taxable years beginning on or after January 1, 1991. In order to pay for the computer programming, data entry, and related expenses needed to implement the provisions of this act, the Department of Revenue is authorized to draw up to $81,500 from individual income tax net collections for the 1990-91 fiscal year.

1990 Chapter 960 (Senate Bill 1617, Senator A. D. Guy)

AN ACT TO PROVIDE THAT THE GOVERNING BODY OF A TAXING UNIT MAY DELAY THE ACCRUAL OF INTEREST ON CERTAIN UNPAID PROPERTY TAXES.

G.S. 105-321(c) requires a taxing unit to deliver its property tax receipts to the tax collector by September 1 each year. This act provides that if the property tax receipts of a taxing unit for the 1989-90 tax year were not delivered to the tax collector before January 1, 1990, the governing body of the taxing unit may adopt a resolution providing that interest will not accrue on those taxes unless they remain unpaid after July 1, 1990. The taxing unit may also refund interest that accrued on these taxes between January 7, 1990, and July 1, 1990. This act is effective upon ratification; although it applies to all taxing units, only Onslow County will likely adopt a resolution authorized by this act. Property tax receipts for a newly annexed area of the Town of Richlands were not delivered to the Onslow County tax collector until after December 31, 1989.

1990 Chapter 970 (Senate Bill 1365, Senator Dennis Winner)

INHERITANCE AN ACT TO REPEAL THE INHERITANCE TAX EXEMPTION FOR FEDERAL RETIREMENT BENEFITS, THEREBY MAKING THE TAX TREATMENT FOR FEDERAL

RETIREMENT BENEFITS THE SAME AS FOR STATE RETIREMENT BENEFITS, AND TO AUTHORIZE THE LEGISLATIVE RESEARCH COMMISSION TO STUDY THE TAX EXEMPTIONS.

In 1989, the General Assembly repealed the inheritance tax exemption for benefits received by a survivor under a State employee retirement program, but inadvertently retained the inheritance tax exemption for benefits received by a survivor under a federal employee retirement program. As a result, beneficiaries of a federal employee retirement program received more favorable treatment than beneficiaries of a State employee retirement program. This act equalizes the inheritance tax treatment of federal and State employee death benefits by repealing the inheritance tax exemption for benefits received by a survivor under a federal employee retirement program, effective September 1, 1990.

This act also authorizes the Legislative Research Commission to study existing inheritance tax exemptions to determine if any changes need to be made in light of amendments to the inheritance tax law enacted since 1985. As part of the Tax Reduction Act of 1985, the General Assembly reduced inheritance taxes. It enacted a total exemption for property passing to a surviving spouse and increased the Class A tax credit, which applies to lineal descendants and ancestors, to an amount that exempts at least $500,000 of property from inheritance tax. The inheritance tax exemptions were not reviewed when these tax reductions were enacted, however.

This act is expected to increase General Fund revenue by an insignificant amount because most death benefits are received by a surviving spouse or a class A beneficiary and would not be taxable due to the existing exemption for surviving spouses and credit for Class A beneficiaries.

This act is based on a recommendation of the Revenue Laws Study Commission that would have expanded the exemption for federal benefits to include State and local benefits but would have limited the exemption to Class A beneficiaries only.

1990 Chapter 981 (House Bill 2067, Rep. Dan Lilley)

AN ACT TO UPDATE THE REFERENCE TO THE INTERNAL REVENUE CODE USED TO DETERMINE CERTAIN TAXABLE INCOME AND TAX EXEMPTIONS.

This act rewrites the definition of the Internal Revenue Code used in State tax statutes to change the reference date from January 1, 1989, to January 1, 1990. Updating the reference makes recent amendments to the Internal Revenue Code applicable to the State to the extent State tax law previously tracked federal law. This update has the greatest effect on State corporate and individual income taxes because these taxes are a percentage of federal taxable income and are therefore closely tied to federal law. The act is effective upon ratification.

Since the State corporate income tax was changed to a percentage of federal taxable income in 1967, the reference date to the Internal Revenue Code has been updated periodically. In discussing bills to update the Code reference, the question frequently arises as to why the statutes refer to the Code as it existed on a particular date instead of referring to the Code and any future amendments to it, thereby eliminating the necessity of bills like this. The answer to this question lies in both a policy decision and a potential legal restraint.

First, the policy reason for specifying a particular date is that, in light of the many changes made in federal tax law recently and the likelihood of continued changes, the State may not want to adopt automatically federal changes, particularly when these changes result

in large revenue losses. By pinning references to the Code to a certain date, the State ensures that it can examine any federal changes before making the changes effective for the State.

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

Recommended by the Revenue Laws Study Committee.

1990 Chapter 984 (House Bill 2138, Rep. Bill Hurley)

AN ACT TO PROVIDE TRANSITIONAL ADJUSTMENTS RELATING TO SUBCHAPTER S CORPORATIONS, TO CORRECT AN ERROR THAT INADVERTENTLY DISALLOWED DEDUCTIONS FOR SOME MORTGAGE INTEREST PAYMENTS, TO PROVIDE ADDITIONAL TAX RELIEF FOR TAXPAYERS WITH DEPENDENTS WHO ARE PERMANENTLY AND TOTALLY DISABLED, TO ALLOW A TAX CREDIT FOR STATE INCOME TAXES PAID ON GOVERNMENT RETIREMENT BENEFITS RECEIVED IN 1988, TO PROVIDE THAT AN EXTENSION OF TIME FOR FILING AN INCOME OR FRANCHISE TAX RETURN IS NOT AN EXTENSION OF TIME FOR PAYING THE TAX, AND TO REDUCE THE THRESHOLD FOR PAYMENTS OF ESTIMATED CORPORATE INCOME TAX.

This act addresses many different tax issues. It addresses some of the unintended tax consequences of the Tax Fairness Act of 1989, it grants a tax credit for State income taxes paid on government retirement benefits received in 1988, it provides that a request for an extension of time to file an income or franchise tax return must be accompanied by a check in the amount of the taxes estimated to be owed, and it reduces the threshold for when a corporation must pay estimated corporate income tax.

The 1989 General Assembly enacted a sweeping reform of the State's personal income tax system by tying the State tax calculation to federal taxable income. The legislation, known as the Tax Fairness Act of 1989, became effective for taxable years beginning on or after January 1, 1989. Despite the scrutiny the legislation received by the General Assembly, and because of the 1989 effective date, there were some tax consequences of the rewrite that were not discovered until after its enactment. The Revenue Laws Study Committee reviewed these consequences and recommended the changes relating to the Tax Fairness Act contained in this act.

Subchapter S Corporations

Since 1958, federal income tax law has allowed certain corporations having fewer than 35 shareholders to elect to be taxed as "Subchapter S Corporations." Under the S Corporation option, items of income and loss are not taxable to the corporation but are passed through to the shareholders in the same way items of income and loss of a partnership are taxed to the individual partners. As part of the Tax Fairness Act of 1989, the State allowed S Corporation tax treatment for federal S Corporations. However, the legislation did not provide for the carryover of pre-1989 losses.

Regular corporations are allowed to carry forward net economic losses for up to five years. The legislation enacted in 1989 did not allow losses at the corporate level prior to the conversion to S Corporation status to be used to offset income under the new system and the 1989 effective date did not give the taxpayers the planning period necessary to adjust to the new system. This resulted in unanticipated tax increases for numerous small businesses in North Carolina, including many farmers.

This act provides as a transitional adjustment an extension of time for loss carryforwards. Pre-1989 net economic losses may be carried forward by an S corporation and used to offset the corporation's income in taxable years beginning on or after January 1, 1989, and before July 1, 1991. The corporation may deduct the loss to one-half of the extent it could have deducted the loss if the S Corporation Income Tax Act had not become effective until July 1, 1991. The loss carryforward may not exceed one-half of the corporation's net income. This offset will be passed through to the shareholders of the corporation. The act makes this section retroactive to the 1989 tax year, allowing affected taxpayers to file amended returns for that year. It will expire for taxable years beginning on or after July 1, 1991.

For an S Corporation that does not use the calendar year as its tax year, certain earnings for the corporation's 1988 tax year were taxed at the corporate level under the old law, because the corporation's tax year started before 1989, and also at the individual level under the new law, because the earnings, distributed as dividends, were included in the shareholder's 1989 taxable income. Prior to the enactment of the Tax Fairness Act of 1989, the "double taxation" may have been avoided through the deduction for N.C. dividends. However, under the new law, dividends receive only a limited tax credit, subject to a $300 maximum. This act provides relief to taxpayers in this situation by allowing a full tax credit, without any maximum, for distributions from pre-1989 earnings made before October 1, 1989, or made by a fiscal year corporation during its 1988 tax year. The act makes the applicable sections retroactive to the 1989 tax year, allowing affected taxpayers to file amended returns for that year.

Mortgage Certificate Credit

Section 25 of the Internal Revenue Code provides that first-time home buyers who do not exceed certain income and sales price levels may obtain a Mortgage Credit Certificate (MCC) that enables the homeowner to take a federal tax credit of up to 25% of the annual mortgage interest payments. The portion of the interest that is taken as a credit may not also be taken as a deduction in calculating federal taxable income. Under the Tax Fairness Act, North Carolina uses federal taxable income as the starting point in calculating North Carolina taxable income; however, it does not allow a tax credit for MCC holders. As a result, an MCC holder whose mortgage interest deduction under the Code was reduced by the amount of the federal credit could not deduct the full amount of the mortgage interest for North Carolina tax purposes. To correct this oversight, this act allows a taxpayer to deduct from taxable income the amount of the mortgage interest that was not deducted under the Code due to the taxpayer's use of the mortgage interest credit. This deduction ensures that 100% of the mortgage interest costs are deductible for State tax purposes. The applicable section is retroactive to the 1989 tax year, allowing affected taxpayers to file amended returns for that year.

Credit for the Disabled

Until the 1989 tax year, North Carolina provided an additional personal exemption for taxpayers and some dependents with certain physical conditions, regardless of whether the

condition led to the person being disabled. These exemptions, which covered 13 different diseases and physical conditions, were repealed by the Tax Fairness Act of 1989. This act provides a tax benefit for persons who were formerly allowed a deduction by granting an additional tax credit for taxpayers with disabled dependents or spouses. The amount of the credit decreases as the taxpayer's income increases and phases out completely when the taxpayer's income reaches a certain point. The base amount of the credit, along with the phase-out thresholds, are listed below:

		Adjusted Gross Income	
	Maximum Credit	Beginning of Phase-Down	End of Phase-Down
Head of Household	$64.00	$16,000	$32,000
Married, filing jointly	80.00	20,000	40,000
Single	48.00	12,000	26,000
Married, filing separate	40.00	10,000	20,000

Credit for Taxes Paid on Federal Retirement in 1988

In 1989, the United States Supreme Court ruled in Davis v. Michigan, 109 S.Ct. 1500 (1989), that the doctrine of intergovernmental tax immunity prohibits a state from taxing federal retirement income at a higher rate than it taxes state retirement income. Prior to 1989, North Carolina allowed a $3,000 income tax exclusion for federal and military retirees; it allowed a full income tax exclusion for State retirement income. Legislation enacted in 1989 to comply with Davis provides that all government retirees receive a $4,000 State income tax deduction. The Davis case was decided on March 28, 1989. The effect of the decision was to allow federal and military retirees a full income tax exclusion for their 1988 government retirement income. However, taxpayers who had already filed their 1988 tax returns could obtain a refund only by demanding it within 30 days after the taxes were paid to the Department of Revenue.

Many taxpayers were unable to obtain refunds of the 1988 State income taxes paid on their federal government retirement income because they did not demand a refund within 30 days after paying their taxes to the Department, which many had filed early. For taxpayers who filed before February 26, 1989, the 30-day period for demanding a refund had already expired on March 28 when the Davis case was decided. The result was that the taxpayers who had filed their returns promptly were penalized while those who filed later received refunds. This act addresses this inequity by allowing taxpayers who received government retirement benefits during the 1988 tax year to claim a credit equal to the amount by which the tax paid by the taxpayer for the 1988 tax year would have been reduced if none of the taxpayer's government retirement benefits had been included in the taxpayer's taxable income. The credit may be claimed in equal installments over the taxpayer's first three taxable years beginning on or after January 1, 1990.

Tax Return Filing Extensions

For federal income tax purposes, the automatic four-month extension of time for filing a return is conditioned upon payment of a reasonable estimate of the tax due when the application for an extension is filed. Federal regulations provide that the penalty for late payment is not imposed if the tax paid with the extension request is at least 90 percent of the

total amount of tax due and the remaining balance is paid with the income tax return on or before the expiration of the extension. This act provides a similar rule for State income tax purposes. For taxable years ending on or after July 19, 1990, an application for an extension of time to file an income or franchise tax return must be accompanied by the full amount of the tax anticipated to be due. The Secretary of Revenue may forgive the penalty for underpayment of the tax for good cause; it is anticipated that the Secretary will adopt a rule like the federal regulation which forgives the penalty if 90% of the tax is paid with the application for an extension.

Corporate Estimated Taxes

Effective August 1, 1990, corporations with an expected annual tax liability of $500.00 or more must make quarterly payment of estimated income tax. Under prior law, only corporations with an estimated annual tax liability of $5,000 had to make the quarterly payment of estimated income tax.

Tax Enforcement

Finally, the act notes that the budget reductions for the Department of Revenue will impair the Department's efforts to modernize the State's tax enforcement program and will have a direct negative impact on the 1990-91 revenue collections. To maintain the integrity of the State's modernized tax enforcement program, the act states an intent that the money generated by this act be used by the Department to continue its tax enforcement programs.

1990 Chapter 989 (House Bill 2073, Rep. Dan Lilley)

AN ACT TO ALLOW A SALES TAX EXEMPTION FOR FUEL USED BY A SMALL POWER PRODUCER TO GENERATE ELECTRICITY.

Effective July 1, 1991, this act creates a sales tax exemption for fuel used by a small power producer to generate electricity. Without the exemption, the fuel would be subject to State sales tax at the rate of 1% under G.S. 105-164.4(a)(1c)d.

The United States Code, in 16 U.S.C. 796(17)(A), defines a "small power production facility" as a facility that produces energy by using primarily biomass waste, renewable resources, geothermal resources, or any combination of these and has a power production capacity of not more than 80 megawatts. The purpose of the federal law is to encourage the production of energy from alternative energy sources.

Coal used to generate electricity is exempt from sales tax under G.S. 105-164.13(3) if it is sold by the producer. Piped natural gas used to generate electricity is subject to State sales tax under G.S. 105-164.4(a)(4a) at the rate of 3% and is not subject to local sales tax. Other fuel used to generate electricity is subject to State sales tax under G.S. 105-164.4(a)(1c)d. at the rate of 1% and is not subject to local sales tax.

This act is expected to result in a revenue loss to the General Fund of $60,000 for the 1991-92 fiscal year. No local revenue loss will occur because under existing law fuel used by a small power producer to generate electricity is not subject to local sales tax.

Recommended by the Revenue Laws Study Committee.

1990 Chapter 1001 (House Bill 2402, Rep. Alex Hall)

AN ACT TO EXPAND THE EGG PROMOTION TAX TO INCLUDE PROCESSED EGGS.

This act levies a tax on processed eggs sold for use in this State. Processed eggs include frozen eggs, liquid eggs, and hard-cooked eggs. There is currently an excise tax on shell eggs in the amount of 5¢ for each case of 30 dozen eggs. Effective October 1, 1990, the excise tax on processed eggs will be 11¢ for each 100 pounds of processed eggs. A person who sells less than 1,000 pounds of processed eggs per year is exempt from this tax.

The Department of Agriculture collects the tax and the money is deposited in the "North Carolina Egg Fund." The money in the Fund is appropriated to the North Carolina Egg Association for research, education, publicity, advertising, and other promotional activities for the benefit of producers of eggs sold in the State.

1990 Chapter 1002 (Senate Bill 1084, Senator Marshall Rauch)

AN ACT TO CONFORM THE LAWS OF NORTH CAROLINA TO THE REQUIREMENTS OF CERTAIN FEDERAL LAWS AND CONSTITUTIONAL PRINCIPLES.

This act makes two changes in North Carolina's tax laws to resolve conflicts with federal laws and federal constitutional principles. Section 1 of the act repeals the separate franchise tax on railroads levied in G.S. 105-115. Section 2 of the act repeals the $1,500 individual income tax exemption allowed under G.S. 105-134.6(b)(4) for compensation received for service in the North Carolina National Guard. Both changes are effective for taxable years beginning on or after January 1, 1990.

Railroad Tax

In 1976, Congress passed the Railroad Revitalization and Regulatory Reform Act. Among other things, the act declares that a State imposes an unreasonable burden on interstate commerce when it imposes a tax that discriminates against a rail carrier (49 U.S.C. 11503(b)(4)). G.S. 105-115 imposes a franchise tax on railroads based on the appraised value of the railroad's property. G.S. 105-122 imposes a franchise tax on corporations based on the highest of the corporation's appraised property value, its net worth, or its net book value of property. The tax rate under G.S. 105-115 is .0075. The tax rate under G.S. 105-122 is .0015.

G.S. 105-115 therefore discriminates against a rail carrier with respect to franchise taxes. It imposes tax at a rate that is five times the rate that applies to most corporations.

To avoid a lawsuit over the constitutionality of G.S. 105-115, the General Assembly decided to repeal it and let the general franchise tax apply to railroads. The repeal of the special tax produces a revenue loss to the General Fund of $1.6 million for fiscal year 1990-91 and $1.7 million for fiscal year 1991-92.

National Guard Exemption

In 1989, the United States Supreme Court held in Davis v. Michigan that a state violates the principle of intergovernmental tax immunity when it gives more favorable tax treatment to itself or those with whom it deals than to the federal government or those with whom the federal government deals unless there are significant differences between the two groups that justify the different treatment. Based on this principle, the court in the Davis case held that it is unconstitutional for a state to exempt retirement income of State employees while taxing retirement income of federal employees. The court saw no significant differences between state employees and federal employees that would justify the different tax treatment.

Before 1989, North Carolina exempted all retirement income of retired State employees and exempted only $3,000 of retirement income of retired federal civil service and military employees. As a result of the Davis decision, the General Assembly changed the law to limit the exemption for State retirement income to $4,000 and to raise the exemption for federal retirement income to $4,000 so that the exemptions would be equal and would comply with federal law.

When the General Assembly changed the law on individual income tax exemptions for retirement income, however, it left a $1,500 exemption for National Guard pay in the law. The National Guard is the State militia and is paid from a combination of State and federal funds. The exemption for National Guard pay has been in the law at the amount of $1,500 since 1979.

The decision not to repeal the National Guard exemption in 1989 led to additional problems concerning the issues raised by the Davis case. In the pending case of Swanson v. Powers, in which the federal retirees seek to obtain refunds of taxes paid on federal retirement pay for the years preceding the 1989 tax year, the federal retirees have argued that the State's failure to repeal the National Guard exemption is evidence that the State does not comply with federal law and should therefore be required to make the refunds requested by the retirees.

In addition, federal armed forces reservists and federal active duty military personnel have amended the complaint in the Swanson lawsuit and claim that the $1,500 exemption for National Guard pay violates the principle established in the Davis case. The reservists and active duty personnel claim that they are entitled to a $1,500 exemption for their federal reserve or active duty pay because the State cannot constitutionally treat its militia better than it treats the federal militia.

Losing the Swanson case would have serious adverse revenue effects on the State's General Fund. If the federal retirees prevail and the State has to refund taxes paid on federal retirement pay, the General Fund will suffer a one-time loss of approximately $80 million. If the federal reservists and active duty military personnel prevail in their claim, the State would have to grant them the same $1,500 exemption and would suffer a revenue loss of $8 million for each year a refund must be made. Because the State has had reason to know the $1,500 exemption is unconstitutional since the Davis decision, the State would almost certainly be held liable for some back refunds and possibly three years' refunds or $24 million. In addition, the State could be required to pay the retirees', reservists', and active-duty military personnel's legal costs of the suit if the State loses.

To avoid the potential revenue losses created by the $1,500 National Guard exemption, the General Assembly decided to repeal it. The repeal indicates the State's good faith compliance with federal law, eliminates a possible recurring revenue loss of $8 million, and produces a revenue gain to the General Fund of $1.9 million for fiscal year 1990-91 and $2 million for fiscal year 1991-92.

1990 Chapter 1005 (Senate Bill 1363, Senator Dennis Winner)

AN ACT TO MODIFY THE TIME ALLOWED FOR FILING CERTAIN PROPERTY TAX APPEALS, TO MAKE THE PENALTY FOR SUBMITTING A BAD CHECK IN PAYMENT OF PROPERTY

TAXES THE SAME AS FOR SUBMITTING A BAD CHECK IN PAYMENT OF OTHER TAXES, AND TO MAKE TECHNICAL CORRECTIONS TO THE PROPERTY TAX STATUTES.

This act makes several conforming and technical changes to the property tax statutes, effective upon ratification. Section 1 makes the time for filing a notice of appeal from a decision of a board of county commissioners the same as the time period for filing a notice of appeal from a decision of a board of equalization and review: 30 days after the date a notice of the decision is mailed to the property owner. Previously, the time for filing a notice of appeal from a decision of a board of county commissioners was 30 days after the decision was entered. Section 2 of the act changes the time when a notice of appeal submitted by mail to the Property Tax Commission is considered to have been filed from the date the notice is actually received to the date the notice is postmarked.

Sections 4 through 7 of the act delete obsolete references to the effective property tax rate. Since 1974, local governments have been required to assess property for taxation at the property's market value. Before then, property could be assessed at a percentage of its market value. These sections delete references to the pre-1974 assessment ratios produced when property was taxed at a percentage of market value.

Sections 8 and 9 make the penalty for submitting a bad check in payment of property taxes the same as for submitting a bad check in payment of other taxes by establishing a $1,000 maximum for all bad checks given in payment of taxes and giving a tax collector the same authority as the Secretary of Revenue to waive the penalty if a taxpayer wrote a bad check on the wrong account through inadvertence. The previous penalty for submitting a bad check in payment of taxes other than property taxes was 10% of the check, subject to a maximum of $200.00, and the penalty could be waived if the Secretary of Revenue found that the taxpayer wrote a bad check on the wrong account through inadvertence. The penalty for submitting a bad check for property taxes was 10% of the check with no maximum and no waiver was allowed under any circumstances.

Sections 1 through 7 of this act have no fiscal effect. Section 8, which increases the maximum penalty for bad checks given in payment of taxes other than property taxes, will increase General Fund revenue by approximately $50,000 annually. Last year, the Department collected $496,137 in bad check penalties. Section 9, which sets a $1,000 maximum bad check penalty for property taxes, will reduce local revenue in a few instances because there is now no cap on the penalty.

Sections 1 through 7 of this act were recommended by the Revenue Laws Study Committee.

1990 Chapter 1027 (Senate Bill 1380, Senator Wendell Murphy)

AN ACT TO PROVIDE FOR A STRAWBERRY ASSESSMENT.

This act creates the "Strawberry Assessment Act." The Act provides a means whereby strawberry producers may voluntarily assess themselves in order to provide funds for strawberry research and marketing. All expenditures of the funds collected must be approved by a funding committee composed of seven members of the North Carolina Strawberry Association, Inc., appointed by the Commissioner of Agriculture.

The Strawberry Association will conduct referenda on the question of whether an assessment should be levied. All persons engaged in the commercial production of strawberries

are eligible to vote in the referenda. The amount of the proposed assessment and the method of collection must be set forth on the ballot.

An assessment cannot be collected unless at least two-thirds of the votes cast in a referendum are in favor of the assessment. The amount of the proposed assessment cannot exceed 5% of the value of the previous year's strawberry plant sales and the period for which each assessment can be levied cannot exceed three years. The Strawberry Association determines the amount of the proposed assessment and the period for which the assessment is levied.

If a referendum receives a two-thirds favorable vote, the Department of Agriculture will notify all strawberry plant growers of the assessment. The assessment would be added by plant growers to the price of all strawberry plants sold for planting in North Carolina. The assessment must be remitted to the Department no later than the 10th day following the end of each calendar quarter; the Department will then forward the money collected to the Strawberry Association.

1990 Chapter 1039 (House Bill 2375, Rep. Larry Justus)

AN ACT TO ENACT THE 1990 OMNIBUS DRUG ACT.

This act makes various changes to criminal offenses involving controlled substances, extends the sunset on investigative grand juries from October 1, 1991, to October 1, 1993, requires registers of deeds to distribute information on the harmful effects on a fetus of substance abuse by the mother, and changes the distribution of the excise tax on controlled substances. Effective retroactively to January 1, 1990, the effective date of the excise tax on controlled substances, the act requires 75% of all excise taxes collected by assessment to be remitted to the State or local law enforcement agency that conducted the investigation that led to the assessment of the tax. If more than one agency conducted the investigation, the Secretary of Revenue must equitably divide the 75% among the investigating agencies.

Under prior law, the proceeds of the excise tax on controlled substances were deposited in a special account designated the State Controlled Substances Tax Fund. As of July 31, 1990, a total of $137,194.29 had been deposited in the Fund while more than $49 million in controlled substance excise taxes had been assessed but not collected. The Department plans to make the first distribution to law-enforcement agencies in the fall of 1990.

1990 Chapter 1047 (House Bill 2394, Rep. Johnathan Rhyne)

AN ACT TO PROVIDE FOR THE FILING OF NOTICES OF LIENS, CERTIFICATES, AND OTHER NOTICES AFFECTING VARIOUS FEDERAL LIENS IN THE SAME MANNER AS NOTICES OF FEDERAL TAX LIENS.

This act replaces the Uniform Federal Tax Lien Registration Act, codified as Article 11 of Chapter 44 of the General Statutes, with the Uniform Federal Lien Registration Act. The act extends the filing requirements that previously applied to federal tax liens to all federal liens, such as a federal lien against real property for costs paid from the federal Hazardous Substance Superfund to remove hazardous substances from the property. The act does not change the filing requirements concerning federal tax liens or the fees charged for filing the liens. The act is effective August 1, 1990.

1990 Chapter 1050 (House Bill 603, Rep. Alex Hall)

AN ACT TO ALLOW CERTAIN INTERSTATE MOTOR CARRIERS TO FILE ANNUAL FUEL USE TAX REPORTS AND TO ALLOW CERTAIN USERS OF DIESEL FUEL TO FILE ANNUAL RATHER THAN QUARTERLY REPORTS.

Effective January 1, 1991, this act allows a motor carrier whose annual fuel use tax liability is no more than $200.00 to file a tax report annually rather than quarterly. The act also authorizes annual, rather than quarterly, special fuel tax reports for users of special fuel (primarily diesel fuel) that use the fuel only in a motor vehicle operated in this State or that file fuel use tax reports annually.

1990 Chapter 1060 (House Bill 2117, Rep. Ray Fletcher)

AN ACT TO PROVIDE THAT FOOD SOLD BY RELIGIOUS ORGANIZATIONS IS EXEMPT FROM TAX.

This act provides a sales tax exemption for food sold by a church or other religious organization not operated for profit when the proceeds of the sales are actually used for religious activities. The exemption applies to sales made on or after August 1, 1990. Under prior law, religious organizations were required to collect the sales tax for all food sales except sales of "Meals on Wheels" to shut-ins.

Religious organizations are allowed a refund of sales taxes paid by them on certain purchases. The State has also given religious organizations other tax advantages. Examples of the existing tax advantages include a federal and State income tax exemption for nonprofit corporations organized for religious purposes, State inheritance and gift tax exemptions for property passing to religious organizations, intangibles tax exemption for nonprofit religious organizations, property tax exemptions for property owned by religious organizations and used for religious or educational purposes, and privilege license tax exemptions for certain exhibitions and performances benefiting religious purposes, for professional religious spiritual healers, and for peddlers and itinerant merchants who are religious organizations.

1990 Chapter 1068 (House Bill 2207, Rep. Lawrence Diggs)

AN ACT TO REMOVE THE OBSOLETE SALES TAX EXEMPTION FOR ICE.

This act repeals the sales tax exemption for the retail sale of ice, thus making sales of ice subject to State sales tax at the rate of 3% and local sales tax at the rate of 2%. However, ice used to preserve agriculture, aquaculture, and commercial fishery products until the products are sold at retail retains its exempt status. This exemption overlaps with the sales tax exemption for supplies sold to commercial fishermen; that exemption, granted by G.S. 105-164.13(9), applies to ice.

Effective September 1, 1990, the repeal of the sales tax exemption for ice is expected to generate $280,000 in additional State tax revenue for the 1990-91 fiscal year, which will have only 10 collection months, and $390,000 in additional State tax revenue in the 1991-92 fiscal year. It is also expected to generate $185,000 in additional local sales tax revenue for the 1990-91 fiscal year, and $260,000 in additional local sales tax revenue in the 1991-92 fiscal year.

The sales tax exemption for ice was enacted in 1937 as an extension of an exemption then in the law for certain food items. The reason for the exemption was that ice was used primarily in ice-boxes to preserve food. Today, food is no longer exempt from sales tax and refrigerators, rather than ice-boxes, are used to preserve food.

1990 Chapter 1069 (House Bill 2257, Rep. H. M. Michaux)

AN ACT TO INCREASE VARIOUS FEES AND CREATE NEW FEES CHARGED BY THE DEPARTMENT OF INSURANCE; TO AMEND THE RETALIATORY PREMIUM TAX LAW; TO CREATE, MAINTAIN, AND APPROPRIATE MONEY TO THE DEPARTMENT OF INSURANCE CONSUMER PROTECTION FUND; AND TO IMPROVE THE FINANCIAL STABILITY OF THE STATE PROPERTY FIRE INSURANCE FUND.

This act makes several changes to the insurance laws. It increases various fees paid by insurers and imposes new fees on insurers, it establishes a $1 million Department of Insurance Consumer Protection Fund, it changes the source of funding for payments to local governments for fire protection provided to State-owned buildings and their contents, and it clarifies the retaliatory insurance tax imposed under G.S. 105-228.8. The clarification of the retaliatory tax is effective retroactively to January 1, 1987, the effective date of the retaliatory tax, and resolves a lawsuit brought against the Department of Insurance by insurance companies over the meaning of the retaliatory tax.

The retaliatory tax issue is intertwined with the differing tax rates on insurance coverage. G.S. 105-228.5 imposes taxes on insurance companies based on the companies' gross premiums. The general rate is 1.75% of gross premiums. Insurers that provide fire and lightning coverage pay an additional tax at the rate of 1.33% of gross premiums for fire and lightning coverage provided on property other than vehicles and boats. Thus, on certain fire and lightning coverage, insurers pay the general rate of 1.75% plus the additional rate of 1.33% for a total combined rate of 3.08%. Twenty-five percent of the additional 1.33% tax, or .33%, must be deposited in the Rural Volunteer Fire Department Fund. That Fund provides matching grants to rural volunteer fire departments for equipment and capital improvements. The remaining 1% of the additional tax and all the general 1.75% tax is deposited in the General Fund.

G.S. 105-228.8 imposes a retaliatory tax on insurers that are chartered in a state other than North Carolina. The purpose of the retaliatory tax is to equalize other states' treatment of insurers chartered in North Carolina and doing business in those states with North Carolina's treatment of insurers chartered in another state and doing business in North Carolina. For example, if North Carolina taxes insurers at 1.75% and Virginia taxes insurers at 3%, G.S. 105-228.8 imposes an additional 1.25% retaliatory tax on Virginia insurers doing business in North Carolina because Virginia taxes a North Carolina insurer that does business in Virginia at 3%.

In calculating whether an insurer owes retaliatory tax, G.S. 105-228.8(e) provides that "special purpose obligations or assessments based on premiums" and "special purpose dedicated taxes based on premiums" cannot be considered. Thus, in the previous example, if North Carolina imposed a special purpose tax of 1.25% in addition to the general 1.75% tax, the retaliatory tax on a Virginia insurer would still be 1.25% because the Virginia insurer could not count the 1.25% special purpose tax in calculating whether the insurer owed retaliatory tax.

Clearly, therefore, the answer to the question whether a tax is a special purpose tax has a significant impact on determining the amount of tax payable to North Carolina by insurers chartered in another state. Before the passage of this act, the Department of Insurance maintained that the additional 1.33% tax on fire and lightning premiums was a special purpose tax and therefore could not be included in a calculation of whether an insurer owed retaliatory taxes. Insurers sued the Department of Insurance and sought refunds of retaliatory taxes paid on the ground that 1% of the 1.33% tax on fire and lightning coverage was not a special purpose tax because it was deposited in the General Fund and should therefore be included in calculating retaliatory tax liability.

The act resolves the lawsuit by conceding the issue and declaring that 1% of the 1.33% tax on fire and lightning coverage is not a special purpose tax. By implication, the remaining .33% of the 1.33% tax is a special purpose tax. The resulting ability of insurers to include 1% of the 1.33% additional tax on fire and lightning coverage in calculating the amount of taxes paid for purposes of the retaliatory tax will reduce General Fund revenue by $1,800,000 each fiscal year.

Because of the retroactive effective date of the retaliatory provision, the Department of Insurance must refund $2.5 million in overpayments of retaliatory taxes made in previous years for which timely refund claims have been submitted. Although not stated in the act, the Department has indicated that it will make the required refunds by allowing a credit for overpayments of retaliatory taxes over a four-year period. The refunds, taken as a credit over four years, will reduce revenue by approximately $640,000 for each of the four fiscal years beginning with the 1990-91 fiscal year. The four-year annual $640,000 reduction is in addition to the $1,800,000 permanent reduction.

1990 Chapter 1073 (Senate Bill 1588, Senator George Daniel)

AN ACT TO SIMPLIFY THE PRIVILEGE LICENSE TAX ON RESTAURANTS.

As the title indicates, this act simplifies the annual privilege license tax imposed on restaurants and other establishments that serve prepared food, effective July 1, 1991, by changing the way the tax is calculated. Under prior law, the tax was $1.00 for each seat in the establishment with a minimum of $50.00. As changed by the act, the tax is a flat $50.00 for establishments that have seating for fewer than five customers and is a flat $85.00 for establishments that have seating for five or more customers.

The act will increase General Fund revenue by $4,000 each year beginning with the 1991-92 fiscal year and will have a varying effect on particular establishments depending on the establishment's seating capacity. The act does not change the privilege tax liability of establishments, such as grocery stores that sell prepared foods at a deli within the store, that have no seating or seating for fewer than five customers. The act increases the privilege tax liability of establishments that have between five and 50 seats from $50.00 to $85.00. The act increases the privilege tax liability of establishments that have more than 50 but no more than 84 seats by the difference between their number of seats and 85. The act decreases the privilege tax liability of establishments that have more than 85 seats; some of these establishments have over 350 seats and will therefore enjoy a decrease in tax liability of at least $265.00.

1989

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1989 Chapter 7 (House Bill 58, Rep. Dan Lilley)

AN ACT TO MAKE CONFORMING CHANGES TO THE MOTOR CARRIER FUEL USE TAX SO THAT A UNIFORM TAX REPORTING FORM MAY BE ADOPTED.

This act amends the motor carrier fuel use tax, effective January 1, 1990, in order to enable North Carolina to adopt a uniform tax reporting form. In Section 19 of the federal Motor Carrier Act of 1980, Congress directed the United States Secretary of Transportation and the Interstate Commerce Commission to study differing state regulations and requirements imposed on interstate motor carriers. As a result, the National Governors' Association formed a working group on state truck issues. The working group developed a consensus agenda and recommended, among other things, that the states adopt a uniform fuel use tax reporting form. The National Conference of State Legislatures has endorsed this recommendation as well.

Before North Carolina could adopt a uniform reporting form, it needed to make minor changes in the scope of the fuel use tax and in the deadline for applying for refunds. This act replaces the definition of motor carrier in G.S. 105-449.37, one who operates "a passenger vehicle with seating capacity for more than 20 passengers, a road tractor, a tractor truck, or a truck with more than two axles," with a new definition, one who operates "a motor vehicle used, designed, or maintained for transportation of persons or property and (i) having two axles and a gross vehicle weight or registered gross vehicle weight exceeding 26,000 pounds, (ii) having three or more axles regardless of weight, or (iii) used in combination when the weight of the combination exceeds 26,000 pounds gross vehicle weight." This act enables the Department of Revenue to eliminate paperwork and simplify the refund process by altering the tax reporting form to provide space on the face of the form for the taxpayer to request a refund. Recommended by Revenue Laws Study Committee.

1989 Chapter 36 (House Bill 4, Rep. Dan Lilley)

AN ACT TO UPDATE THE REFERENCE TO THE INTERNAL REVENUE CODE USED TO DETERMINE CERTAIN TAXABLE INCOME AND TAX EXEMPTIONS.

This act rewrites the definition of the Internal Revenue Code used in State tax statutes to change the reference date from January 1, 1988, to January 1, 1989. Updating the reference makes recent amendments to the Internal Revenue Code applicable to the State to the extent State tax law previously tracked federal law. This update has the greatest effect on State corporate and individual income taxes because these taxes are a percentage of federal taxable income and are therefore closely tied to federal law. The act is effective upon ratification.

Since the State corporate income tax was changed to a percentage of federal taxable income in 1967, the reference date to the Internal Revenue Code has been updated periodically. In discussing bills to update the Code reference, the question frequently arises as to why the statutes refer to the Code as it existed on a particular date instead of referring to

the Code and any future amendments to it, thereby eliminating the necessity of bills like this. The answer to this question lies in both a policy decision and a potential legal restraint.

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

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

1989 Chapter 37 (House Bill 5, Rep. Dan Lilley)

AN ACT TO MAKE TECHNICAL CHANGES TO THE REVENUE LAWS.

This act makes numerous technical and conforming changes to the revenue laws. Except as otherwise noted, the provisions of the act are effective upon ratification.

Section 1 amends G.S. 105-130.19 to eliminate an installment payment option allowing corporations to pay income tax within an additional period of nine months after the due date of the income tax return. Effective for taxable years beginning on or after January 1, 1989, this amendment brings the statute in harmony with another provision of the law, G.S. 105-163.41, which requires that 90% of the income tax be prepaid before the due date of the return. Because few corporations elect to use the installment method under G.S. 105-130.19, its elimination will not have a significant impact on taxpayers and will be more cost efficient for the Department of Revenue.

Section 2 deletes two obsolete references to the Internal Revenue Code of 1954 and replaces them with references to "the Code," elsewhere defined as the Internal Revenue Code of 1986. Section 3 amends G.S. 105-147(7) to eliminate a loophole that allowed a nonresident individual to take an income tax deduction for a prorated portion of deductible dividends even if the dividends were not taxable to North Carolina. G.S. 105-147 was later repealed, however, by the Tax Fairness Act of 1989. See Chapter 728, discussed below.

Section 4 amends G.S. 105-159.1(b) to delete a reference to the Election Campaign Fund and substitute the "Political Parties Financing Fund" in order to conform the statute to a change in the name of the Fund made in 1988. Section 5 repeals G.S. 105-163.05 effective for taxable years beginning on or after January 1, 1990. This statute, which allows an income tax credit for property taxes paid on poultry and livestock, is obsolete because the General Assembly exempted poultry and livestock from property taxes effective with the 1989 tax year.

Section 6 amends G.S. 105-242(b) to provide that the procedure used for serving garnishments will be the same for both local and State taxes. Currently, for property taxes, notice of garnishment may be served "in any manner provided by Rule 4 of the North Carolina Rules of Civil Procedure." (G.S. 105-368). Before this amendment, in the case of State taxes, personal service was required, which could cause embarrassment for the taxpayer if service was made at his or her workplace. Section 6 changes the law for State taxes to allow service as provided in Rule 4.

Section 7 clarifies an ambiguous provision in the Machinery Act. G.S. 105-375(c) provided in certain foreclosure procedures for the assessment of administrative costs against the taxpayer but did not specify whether these costs are to be paid to the clerk of court or to the taxing unit. Section 7 amended the statute to clarify that the costs go to the taxing unit. Section 8 amends G.S. 106-277.28 to eliminate a loophole placed in the statute when it was amended in 1988. The statute set out a license tax for seed dealers with sales of less than $500.00 and for seed dealers with sales of more than $500.00, but none for seed dealers with sales of exactly $500.00. Section 8 corrects that problem. Recommended by Revenue Laws Study Committee.

1989 Chapter 79 (House Bill 78, Rep. Charles Beall)

AN ACT TO MAKE AVAILABLE TO COUNTIES INFORMATION HELPFUL IN CHOOSING A FIRM TO CONDUCT A REAPPRAISAL AND TO ALLOW THE DEPARTMENT OF REVENUE TO ASSIST COUNTIES DURING THE CONTRACT PHASE OF COUNTY REAPPRAISAL.

Effective for taxable years beginning on or after January 1, 1990, this act requires the Department of Revenue to assist counties, upon their request, in the preparation of the specifications and proposed contracts related to the selection of private contractors employed to conduct the county's general revaluation of real property. Although prior law did not require the Department to assist counties in the preparation of their specifications and contracts, the Department provided this service, as well as other services related to county reappraisals.

G.S. 105-289(i) requires the Department to maintain a register of appraisal firms and other firms having expertise in one or more duties of the assessor. To register with the Department, the firms must file an annual report with the Department setting forth their qualifications, financial condition, and a complete resume of their employees, experience, and training. This register is available to the counties as a resource in choosing an appraisal firm. To make this tool more valuable to the counties, this act requires that additional information be maintained in the register to give counties a measure of a firm's quality of work.

The act first requires that a report submitted to the Department by a county evaluating an appraisal firm that conducted the county's revaluation be included in the register and indexed under that appraisal firm. The report can outline any problems encountered in the reappraisal process, the number of appeals submitted, and the success rate of the appeals.

Secondly, the act requires the Department to include in its register a county's median ratio for the first two years following the effective date of the county's revaluation and the county's coefficient of dispersion for those two years, indexed under the appraisal firm that conducted the revaluation. The median ratio provides the most accurate representation of the overall level of assessment of real property. The coefficient of dispersion provides the most accurate representation of the degree of uniformity of assessment among the properties. Recommended by the Property Tax Appraisal Study Committee.

1989 Chapter 99 (Senate Bill 49, Senator Frank Block)

AN ACT TO ELIMINATE THE FOUR-YEAR OWNERSHIP REQUIREMENT FOR USE-VALUE FORESTLAND TRANSFERRED TO THE OWNER OF OTHER USE-VALUE FORESTLAND.

This act allows an owner of forestland that is classified for taxation at its use value to acquire other land that is classified for taxation at its use value or is eligible for use value classification and, upon acquiring the land, to have the newly acquired land immediately classified for taxation at its use value. In making this change, the act conforms the treatment of forestland with that of horticultural land and agricultural land; these types of land enjoy immediate use value classification when transferred to a person who already owns land classified at use value.

Before this act, an owner of classified forestland who acquired other classified forestland had to wait four years after acquiring the other forestland before being able to have the other land classified for taxation at its use value. This result followed from the general requirement that, to be eligible for taxation at use value, land owned by an individual must be the individual's place of residence or have been owned by the individual for four years and land owned by a corporation must have been owned by the corporation or one of its principal stockholders for four years.

The act is effective for taxable years beginning in 1989, but the benefit applies to land acquired before 1989 as well as during or after 1989. To give taxpayers sufficient notice of this change, the act allows an application for use value to be filed until September 1, 1989. Normally, these applications must be submitted during the regular listing period.

1989 Chapter 111 (House Bill 198, Rep. Al Lineberry)

AN ACT TO MAKE TECHNICAL CHANGES TO THE TAX CREDIT FOR CREATING JOBS IN SEVERELY DISTRESSED COUNTIES.

In 1987, the General Assembly enacted income tax credits for corporations and individuals that create jobs in severely distressed counties. These credits, set out in G.S. 105-130.40 and G.S. 105-151.17, respectively, allow a credit of $2,800 to eligible taxpayers for each additional full time employee hired in a severely distressed county. A severely distressed county was defined as a county whose combined unemployment and per capita rankings were among the twenty worst in the State and that had an unemployment rate of 7% or higher.

This act makes the following changes to the credit, effective for taxable years beginning on or after January 1, 1989:

(1) It removes the requirement that, to be eligible for the credit, a taxpayer must be engaged in manufacturing, agribusiness, processing, warehousing, wholesaling, retailing, research and development, or a service-related industry, as determined by the Employment Security Commission. This requirement was meaningless because the Employment Security Commission determined that there were no businesses that failed to fall into one of the categories. The credit was further amended by Chapter 753 of the 1989 Session Laws, discussed below, to limit the credit to taxpayers engaged in manufacturing goods or in an industrial activity.

(2) It deletes a provision requiring the Employment Security Commission to calculate and report to the Department of Revenue the number of new jobs created by employers.

Instead, taxpayers are required to maintain and make available to the Secretary of Revenue records to verify the taxpayer's eligibility for the credit. The burden of proving eligibility for the credit and the amount of the credit was placed on the taxpayer.

(3) It deletes the requirement that a county must have an unemployment rate of 7% or more to be designated a severely distressed county.

Chapter 753 of the 1989 Session Laws, discussed below, increases the number of severely distressed counties from 20 to 25.

1989 Chapter 148 (Senate Bill 523, Senator Ted Kaplan)

AN ACT TO AUTHORIZE FULLY CERTIFIED LOCAL AIR POLLUTION CONTROL PROGRAMS TO CERTIFY POLLUTION CONTROL EQUIPMENT FOR TAX PURPOSES.

Under prior law, the owner of certain pollution control equipment was entitled to tax benefits under the corporate franchise tax (G.S. 105-122), corporate (G.S. 105-130.10) and individual income taxes, and property tax (G.S. 105-275(8)) if the Department of Natural Resources and Community Development (now, Department of Environment, Health, and Natural Resources) certified that the equipment complied with all applicable requirements. Effective with the 1989 tax year, this act provides that certification of the equipment by a fully certified local air pollution control program is sufficient to qualify the equipment for the tax benefits. Incidentally, the special individual income tax benefit for this equipment was repealed by Chapter 728 of the 1989 Session Laws effective for taxable years beginning on or after January 1, 1989.

1989 Chapter 176 (Senate Bill 63, Senator Bob Martin)

AN ACT TO AUTHORIZE A COUNTY TO PERMIT TAXPAYERS TO APPEAL DECISIONS OF THE BOARD OF EQUALIZATION AND REVIEW TO THE BOARD OF COUNTY COMMISSIONERS.

Effective for taxable years beginning on or after January 1, 1990, this act allows the board of county commissioners to include in the resolution creating a special board of equalization and review a procedure for appeal of the special board's decisions as to the listing or appraisal of real property to the county commissioners. The act allows but does not require the appeal procedure to be included in the resolution. If an appeal procedure is included in the resolution, the board of county commissioners has the authority to change the orders of the special board on the abstracts and tax records when necessary to give effect to the decisions it makes during the appeal hearings.

Under prior law, the only avenue of appeal available to the taxpayer from a decision of the special board of equalization and review was to the Property Tax Commission. The board of county commissioners could not change an order of the special board once the change the special board ordered had been entered on the abstracts and tax records. Recommended by the Property Tax Appraisal Study Committee.

1989 Chapter 196 (Senate Bill 28, Senator Joe Johnson)

AN ACT TO ALLOW THE BOARD OF EQUALIZATION AND REVIEW TO ADJOURN ON DECEMBER 1 IN THE YEAR OF A COUNTY REVALUATION OF REAL PROPERTY.

Under prior law, a county board of equalization and review had to complete its duties by July 1. The counties that experienced problems in their revaluation process often had a difficult time granting hearings to property owners under the July 1 time constraint. Effective for taxable years beginning on or after January 1, 1990, this act extends the time a board of equalization and review has to complete its duties to December 1 in the year the county conducts a revaluation. The July 1 deadline remains the same for non-revaluation years. Recommended by the Property Tax Appraisal Study Committee.

1989 Chapter 251 (Senate Bill 411, Senator Alexander Sands)

AN ACT TO PERMIT THE ROCKINGHAM COUNTY AIRPORT AUTHORITY TO RECEIVE ANNUAL SALES TAX REFUNDS.

This act adds the Rockingham County Airport Authority to the list of local governmental entities that can apply for a refund of State and local sales and use taxes paid by them. The governmental entities eligible for sales and use tax refunds are listed in G.S. 105-164.14(c) and include counties, cites, water and sewer authorities, and regional councils of government. Eligible governmental entities may file for annual sales and use tax refunds of taxes paid during the preceding fiscal year, except sales taxes paid on electricity, natural gas, or telephone service.

The act is effective July 1, 1989, and permits the Rockingham County Airport Authority to apply for a refund of sales and use taxes paid during fiscal year 1988-89 by submitting an application before July 31, 1989. Without this authorization, the refund provisions would have applied only to sales and use taxes paid after the effective date of the act.

1989 Chapter 346 (Senate Bill 552, Senator Bill Goldston)

AN ACT TO REPEAL THE SUNSET DATE APPLICABLE TO INSURANCE PREMIUM TAXES.

This act repeals the insurance premium tax sunset that was set at January 1, 1988, by Section 5.1 of Chapter 1031 of the 1986 Session Laws and extended to January 1, 1990, by Section 4 of Chapter 814 of the 1987 Session Laws. The repeal of the sunset thus leaves in effect the reform of the taxes on gross premiums of insurance companies made in 1985 and 1986.

In 1985 and 1986, the General Assembly changed the rates of tax on gross premiums of insurance companies in response to a United States Supreme Court case, Metropolitan Life Insurance Company v. Ward, which held it unconstitutional to tax premiums of foreign insurance companies at a higher rate than premiums of domestic insurance companies. Before the changes that were made in 1985 and 1986, the State taxed premiums of domestic insurance companies at lower rates than those of foreign insurance companies. Now, the State premium tax rates are the same for foreign and domestic companies. To achieve this equality, the domestic tax rate was increased from 1.5% to 1.75% and the foreign tax rate was decreased from 2.5% to 1.75%.

1989 Chapter 392 (House Bill 784, Rep. C. P. Stewart)

AN ACT TO ALLOW AN EXTENSION OF TIME FOR THE CITY OF DUNN TO FILE AN APPLICATION FOR A SALES TAX REFUND.

G.S. 105-164.14 allows certain local governmental entities to receive annual refunds of sales and use taxes paid on direct purchases of tangible personal property. In order to receive the full refund, the entity must submit an application within six months after the end of the fiscal year. An entity that submits its application within the next six months after the due date can receive a partial refund. No refunds are allowed for applications that are more than six months late. The City of Dunn failed to file an application for a refund for taxes paid during the 1986-87 fiscal year; this act allows the city a full refund of these taxes if it files an application by December 31, 1989.

1989 Chapter 435 (Senate Bill 119, Senator A. D. Guy)

AN ACT TO REPEAL THE PRIVILEGE LICENSE TAX FOR FLEA MARKET VENDORS, TO INCREASE THE TAX FOR FLEA MARKET OPERATORS, TO EXEMPT GOVERNMENTAL ENTITIES FROM THE TAX, TO REDEFINE FLEA MARKETS AS "SPECIALTY MARKETS", AND TO INCREASE THE PENALTY FOR CERTAIN VIOLATIONS.

Under prior law, G.S. 105-53 imposed a privilege license tax on peddlers, itinerant merchants, flea market operators, and flea market vendors. Before July 1, 1988, this statute had taxed flea market operators but not the flea market vendors to whom the operators rented space. Legislation enacted in 1987 to become effective July 1, 1988, levied a twenty-five dollar license tax on flea market vendors and required license applicants to provide positive identification before receiving the license. The new law also required peddlers, itinerant merchants, and flea market operators and vendors to display their licenses and required flea market operators to maintain a list of all flea market vendors selling at the flea market. Finally, the 1987 law provided that violation of the license tax and other requirements is a misdemeanor punishable by up to 30 days' imprisonment, up to two hundred dollars' fine, or both.

The intent of the 1987 law was to deter the sale of stolen goods at flea markets and provide consumers the means to trace a vendor who may have sold shoddy merchandise. During 1988 and 1989, a number of problems with the new law were brought to the attention of the General Assembly.

Representatives of the License and Excise Tax Division of the Department of Revenue noted that the identification requirements forced the Department to process the license applications manually. This problem, along with the volume of new vendor licenses, drained the resources of the Division, leading to backlogs in processing privilege licenses of all sorts. In addition, the Division staff had been unable to notify all vendors newly subject to tax, leading to uneven enforcement and bad publicity when vendors were surprised by the tax. Local government officials were troubled by the new law as well. One of the technical definitions contained in the statute subjected municipalities to the flea market operators' tax.

By far the most numerous complaints concerning the license tax came from taxpayers. Operators of consumer trade shows, such as furniture shows, antique shows, and coin dealer shows, objected to the imposition of the tax on their vendors. They found the label "flea market" offensive when applied to their shows and pointed out that a consumer trade show vendor was not the type of vendor that would sell stolen goods or refuse to make a refund to a dissatisfied customer. The trade show operators also pointed out that because neighboring states do not impose a tax on vendors, operators and vendors were moving their shows out of North Carolina to avoid the tax. In addition, flea market operators and vendors complained about the new

tax, stating that it imposed an unreasonably heavy burden on vendors, many of whom are elderly or handicapped and have little or no other income. They also noted several instances in which the tax was enforced against flea markets but not against trade shows and festivals that are also liable for the tax. Finally, all parties subject to the tax complained of the difficulty of providing a copy of a positive identification before being able to obtain the license.

The Revenue Laws Study Committee developed this act to address all of these concerns and to maintain a mechanism for protecting consumers and deterring sale of stolen goods at flea markets. The act repeals the license tax on flea market vendors and raises the tax on flea market operators from $100.00 to $200.00. In addition, it substitutes the term "specialty market" for "flea market" in the statute because consumer trade shows as well as flea markets are covered by the law. The act repeals the requirement that licensees submit a copy of a positive identification before receiving a license; this change will eliminate the need for the Department to process applications by hand. The act addresses the concerns of local governments by exempting units of government from the tax. Finally, the act enhances efforts to regulate licensees and make them accountable by (i) requiring specialty market vendors and operators and other licensees to show positive identification upon the request of a customer or a State or local revenue or law enforcement officer, in addition to displaying their retail sales tax license; (ii) requiring specialty market operators to keep a list with the name, address, and sales tax number of every vendor at the market; (iii) requiring specialty market operators to refuse to allow vendors to sell if they do not have a retail sales tax license; and (iv) imposing an increased penalty of up to $1,000 for a specialty market operator or vendor who fails to comply with these requirements. The act became effective July 1, 1989. Recommended by Revenue Laws Study Committee.

1989 Chapter 522 (Senate Bill 175, Senator Joe Raynor)

AN ACT TO ALLOW COUNTIES TO COMPROMISE THE ONE HUNDRED DOLLAR PENALTY FOR FAILURE TO LIST A MOTOR VEHICLE AND TO CLARIFY OTHER PROVISIONS OF G.S. 105-312 RELATING TO THE PENALTY.

G.S. 105-312(h1) imposes a $100 penalty for falsely certifying that a vehicle has been listed for property tax purposes. This act provides that a county may compromise the $100 penalty, as it may the penalty for failure to list a vehicle, if the penalty has not already been paid.

Section 2 of the act creates an exception to the prohibition on compromising penalties that have already been paid. It provides that, for $100 penalties paid for 1988 and 1989 only, a county may refund the penalty if it determines that the taxpayer's false certification was not made intentionally to avoid the property tax. The authority to make these refunds may be delegated to the county finance officer or another county official.

The act further provides that the procedure for collecting the $100 penalty shall be the same as for other penalties. These changes become effective with the 1989 tax year.

1989 Chapter 530 (Senate Bill 787, Senator Paul Smith)

AN ACT TO AUTHORIZE THE SECRETARY OF REVENUE TO SET THE INTEREST RATE FOR STATE TAX ASSESSMENTS EVERY SIX MONTHS.

The Secretary of Revenue sets the interest rate that is charged on late payments of taxes, G.S. 105-241.1(i), and that is paid on tax refunds, G.S. 105-266 through 105-267. Effective June 30, 1989, this act changes the frequency with which the rate is set from once a year to twice a year. It directs the Secretary to set a rate by June 1 of each year to be in effect from July 1 to December 31, and to set a rate by December 1 of each year to be in effect from January 1 to June 30. If the Secretary does not set a new rate by the designated date, the rate for the previous six-month period continues in effect.

The Secretary must therefore set a rate by December 1 of this year that will be in effect from January 1, 1990, to June 30, 1990. Before this act, the Secretary set the interest rate to be in effect during a calendar year by December 1 of the previous year. As under the previous law, the rate cannot be more than 16% a year or less than 5% a year.

1989 Chapter 531 (Senate Bill 893, Senator George Daniel)

AN ACT TO CONFORM THE NORTH CAROLINA GENERATION SKIPPING TRANSFER TAX TO THE INTERNAL REVENUE CODE.

This act makes technical corrections to the State's generation skipping transfer tax statute. It conforms the language and the Code references in the North Carolina statute to the Internal Revenue Code. It imposes the tax not only upon a taxable distribution and a taxable termination, but also upon a direct skip as determined under the provisions of the federal generation skipping transfer tax. A direct skip is a transfer to a person who is two or more generations younger than the transferor. For example, a transfer of an interest in property by a grandparent to a grandchild would be considered a direct skip. The act is applicable to decedents dying on or after the date of ratification, June 30, 1989.

1989 Chapter 557 (House Bill 272, Rep. George Miller)

AN ACT TO CREATE A TAX AMNESTY PROGRAM AND IMPROVE STATE TAX ENFORCEMENT AND COMPLIANCE TO ASSURE FAIRNESS IN THE COLLECTION OF TAXES FROM ALL TAXPAYERS.

Called the "Fair Share Tax Act of 1989," this act seeks to ensure that all taxpayers are paying taxes owed by them. To achieve this purpose, the act creates a one-time tax amnesty program, raises the criminal penalties for failure to pay taxes, and appropriates funds to the Department of Revenue to collect taxes.

The amnesty program established by the act applies during the 3-month period from September 1, 1989, through December 1, 1989. During this period, a person who pays previously unreported, underreported, or assessed but unpaid taxes, plus the interest due on the taxes, cannot be criminally prosecuted. In addition, a person who prepares a tax return submitted under the amnesty program cannot be prosecuted for willfully aiding another to evade taxes.

The amnesty program applies to almost all taxes collected by the State. It applies to inheritance and gift taxes, State privilege license taxes, excise taxes, franchise taxes, income taxes and income withholding taxes, State and local sales and use taxes, intangible taxes,

motor fuel taxes, and motor fuel inspection taxes. It does not apply to insurance gross premium taxes. The amnesty program is expected to generate $25,000,000 in one-time revenue.

Effective with the end of the amnesty period on December 2, 1989, the act increases several of the criminal penalties that apply to the failure to pay taxes. The specific increases are:

VIOLATION	PRIOR LAW	NEW LAW
Attempt to evade or defeat tax **G.S. 105-236(7)**	Misdemeanor: -$1,000 fine -6 months imprisonment, -or both	Class I felony: -$25,000 fine -5 years imprisonment, -or both Presumptive: 2 years
Willful failure to collect, withhold, or pay over tax **G.S. 105-236(8)**	Misdemeanor: -$1,000 fine -2 years imprisonment, -or both	Misdemeanor: Same punishment but extends time within which a person can be prosecuted from 2 years to 3 years
Willful failure to file return, supply information, or pay tax **G.S. 105-236(9)**	Misdemeanor: -Unlimited fine - 2 years imprisonment, -or both	Misdemeanor: Same punishment but extends time within which a person can be prosecuted from 2 years to 3 years
Willful aiding or assisting in filing fraudulent return or document **G.S. 105-236 (9a)**	Misdemeanor: -Unlimited fine -2 years imprisonment, -or both	Class J felony: -$10,000 fine -3 years imprisonment, -or both Presumptive: 1 year

To ensure better compliance with the tax laws, the act couples the increased criminal penalties with appropriations to the Department of Revenue for additional enforcement personnel and related costs. The act appropriates $5,071,142 for the 1989-90 fiscal year and $4,914,908 for the 1990-91 fiscal year. In addition, the act authorizes the Department of Revenue to use up to $1,100,000 of income tax revenue to publicize and pay for the tax amnesty program. The increased criminal penalties coupled with better enforcement are expected to generate additional recurring revenues of $69,000,000 each fiscal year. Recommended by Tax Fairness Study Commission.

1989 Chapter 578 (Senate Bill 628, Senator Marshall Rauch)

AN ACT TO ALLOW THE GOVERNING BODY OF A COUNTY OR ITS MUNICIPALITIES TO CONTRACT WITH FINANCIAL INSTITUTIONS FOR RECEIPT OF PAYMENT OF PROPERTY TAXES.

This act gives the governing body of a taxing unit the authority to enter into a contract with a bank or other financial institution under which the institution agrees to collect property taxes owed the taxing unit. This type of arrangement for collection of property taxes is

commonly known as "lockbox" property tax collection. Without this act or a special local act, the governing body could not enter into this type contract.

Several limitations apply to the collection of property taxes by an institution. The institution can collect only those taxes that are current; it cannot collect overdue taxes on which interest is payable. In addition, the institution cannot give a receipt for payment of taxes; only the tax collector can issue a tax receipt for payment of taxes.

The same benefits apply to the payment of property taxes at an institution as at the tax collector's office. The institution must give the taxpayer any discount allowed by the taxing unit for early payment of taxes, and the taxpayer may pay by check. If the check is returned unpaid, the institution notifies the tax collector, who proceeds to collect the unpaid taxes in the same manner as other unpaid property taxes.

The act is effective upon ratification and repeals local acts authorizing specific taxing units to contract for receipt of payment of property taxes. With the enactment of this general law, the local acts are no longer needed. The local acts applied to Cleveland, Gaston, Iredell, and Wake Counties and to the taxing units in those counties.

1989 Chapter 580 (Senate Bill 788, Senator Paul Smith)

AN ACT TO PERMIT THE DEPARTMENT OF REVENUE AND LOCAL TAX COLLECTORS TO ATTACH THE ESCHEAT FUND.

This act permits the State or a local property tax collector to recover property in the Escheat Fund and apply the property to the payment of State or local taxes, as appropriate, if the State Treasurer determines that the person who owned the escheated property owed taxes. The act is effective July 5, 1989, the date it was ratified. Previously, it was unclear whether the State or a local tax collector could attach this property in the Escheat Fund in payment of taxes.

Escheated property is property to which the State assumes ownership under Chapter 116B of the General Statutes, either because the property is determined to be abandoned or the property was owned by a person who died and had no heirs. Article IX, 10 of the North Carolina Constitution requires property in the Escheat Fund to be used to "aid worthy and needy students who are residents of this State and are enrolled in public institutions of higher education in this State." The State Treasurer administers the Escheat Fund and resolves the claims of any creditors of those who owned property that has escheated.

1989 Chapter 582 (House Bill 330, Rep. Dave Diamont)

AN ACT TO REPEAL OBSOLETE CORPORATE FRANCHISE TAX EXEMPTIONS AND CLARIFY THE DEFINITION OF PRIVATE TELECOMMUNICATIONS FOR CORPORATE FRANCHISE TAX PURPOSES.

Effective for taxable years beginning on or after January 1, 1989, this act clarifies existing law and repeals obsolete corporate franchise and corporate income tax credits. Section 1 repeals G.S. 105-129.1, which provides a manufacturer a refund of franchise taxes paid on natural gas used as an ingredient or component (raw material) of a manufactured product. This provision has not been used in several years.

Section 2 clarifies the term "private telecommunications service" to conform the statutory definition to the administrative policy. The act deletes language that limits the service to priority use of channels between exchanges, thereby clarifying that all private telecommunications services are subject to the 6.5% sales tax levied under G.S. 105-164.4(4c).

Section 3 of the act repeals the tax credit provisions of G.S. 105-120(b), which applied when a city or town sold at public auction the right to engage in a telephone business in the town for a percentage of the receipts and then collected revenue not exceeding 1% of the receipts. Under prior law, the amount of revenue the municipality collected from its percentage of the gross receipts was credited entity against the franchise tax liability of the telephone company. This credit provision was enacted in 1931 but has no application today. In recent years, the credit has not been used by taxpayers liable for the tax levied under G.S. 105-120(b). Recommended by the Tax Fairness Study Commission.

1989 Chapter 584 (House Bill 512, Rep. George Miller)

AN ACT TO AMEND ARTICLE 2, "LICENSE TAXES," OF THE REVENUE ACT TO PROVIDE FOR TAX SIMPLIFICATION AND TO RAISE REVENUES.

The State levies annual privilege license taxes on a variety of businesses under Article 2 of Chapter 105 of the General Statutes. Effective for privilege license taxes levied for fiscal year 1990-91, this act amends many of the privilege license tax provisions to:

(1) Eliminate tax rates based on the population of the city where the business is located or other variables such as seating capacity.

(2) Consolidate 10 of the privilege license taxes into one "general business" $50.00 license tax under new G.S. 105-102.5.

(3) Increase many privilege license taxes that were below $50.00 to $50.00.

(4) Repeal two privilege license taxes.

VARIABLE PRIVILEGE LICENSE TAXES CHANGED TO FLAT RATE

Under prior law, at least 18 privilege license taxes were based on population or other variables, such as seating capacity or number of vehicles used. For those taxes based on population, the amount of the tax increased as the population of the city where the business was located increased. If a business was located in an unincorporated area, the smallest tax based on population applied to the business. To administer the license taxes that were based on population, the Department of Revenue applied the population figures resulting from the most recent 10-year census.

The act changes all tax rates based on population and most of the tax rates based on other variables to a single rate that applies regardless of the population where the business is located or of other factors peculiar to each taxpayer. The new tax rate is generally a rate approximately midway between the former lowest and highest rates. If the former highest rate was less than $50.00, however, the new rate is $50.00. In many instances, therefore, taxpayers in the more populous cities will enjoy a tax decrease while those in the less populous cities experience a tax increase.

The privilege license taxes that previously varied on the basis of population or other factors and that have been changed to a single rate of tax are listed below along with the new tax rate.

LICENSE	MINIMUM AND MAXIMUM Tax Based on Population	NEW RATE
Drive-in Movie G.S. 105-36.1	Minimum: .67 per car Maximum: $1.34 per car	$100.00
Movie Theater G.S. 105-37	Minimum: $62.50 per theater Maximum:: $1,200 per theater	$200.00 per theater
Athletic Events, Dances, and Other Entertainment G.S. 105-37.1	Minimum: $10.00 per place Maximum: $50.00 per place	$50.00 per place
Circuses and Other Traveling Shows G.S. 105-38	Minimum: $7.50 per motor vehicle Maximum: $300.00 per rail	$50.00 each day a performance is given
Undertakers and Retail Dealers in Coffins G.S. 105-46	Minimum: $10.00 Maximum: $100.00	$50.00
Pawnbrokers G.S. 105-50	Minimum: $200.00 Maximum: $400.00	$275.00
Security Dealers Without Ticker Tape Service G.S. 105-67(a)	Minimum: $25.00 Maximum: $300.00	$200.00
Security Dealers With Ticker Tape Service G.S. 105-67(d)	Minimum: $150.00 Maximum: $600.00	$450.00
Dry Cleaners G.S. 105-74	Minimum: $7.50 Maximum: $75.00	$50.00
Laundries G.S. 105-85	Minimum: $6.25 Maximum: $62.50	$50.00
Placing Outdoor Advertising In a City G.S. 105-86	Minimum: $5.00 Maximum: $200.00	$70.00
Automotive Service Stations G.S. 105-89(a)	Minimum: $10.00 Maximum: $5.00 times the number of pumps	$50.00
Wholesale Auto Parts Dealers G.S. 105-89(b)	Minimum: $25.00 Maximum: $125.00	$75.00

LICENSE	MINIMUM AND MAXIMUM Tax Based on Population	NEW RATE
Motor Vehicle Dealers G.S. 105-89(c)	Minimum: $25.00 Maximum: $200.00	$100.00
Motorcycle and Motorcycle Parts Dealers G.S. 105-89.1	Minimum: $10.00 Maximum: $40.00	$50.00
Unemployment Agencies G.S. 105-90 G.S. 105-90.1	Minimum: $100.00 Maximum: $500.00	$300.00
Plumbers, Heating Contractors, and Electricians G.S. 105-91	Minimum: $7.50 Maximum: $40.00	$50.00

FLAT-RATE PRIVILEGE LICENSE TAXES INCREASED TO $50

The act increases most of the privilege license taxes that were less than $50.00 to that amount to make collection of the taxes cost effective. In addition, the act increases several minimum taxes to $50.00 for the same reason.

The act does not increase a few taxes to $50.00, such as the $15.00 tax on electronic video games, because, although the rate itself is less than $50.00, the rate applies to each place or taxable article and a taxpayer who applies for a privilege license includes all places or articles on the same application and therefore generally pays more than $50.00. These taxes are therefore cost effective to collect despite the low rate.

The flat-rate privilege license taxes that were increased to $50.00 are:

1. Attorneys, doctors, dentists, veterinarians, opticians, registered engineers and land surveyors, landscape architects, photographers, realtors, accountants, morticians, and certain other professionals, G.S. 105-41. The former tax was $25.00.
2. Private detective or private investigator, G.S. 105-42. The former tax was $25.00.
3. Installing, servicing, monitoring, or responding to alarms, G.S. 105-51.1. The former tax was $25.00.
4. Contractor project licenses for projects costing less than $10,000, G.S. 105-54(b). The former tax was $25.00.
5. Day-care facilities caring for fewer than 50 children, G.S. 105-60. The former tax was $10.00 for fewer than 30 children and $60.00 for 30 to 49 children.
6. Hotel and motel minimum privilege license, G.S. 105-61. The former tax was $2.00 per room, with a minimum of $10.00. The new tax is $2.00 per room, with a minimum of $50.00.
7. Restaurants and other prepared food vendors minimum privilege license, G.S. 105-62. The former tax was $1.00 per customer seat, with a minimum of $5.00. The new tax is $1.00 per customer seat, with a minimum of $50.00.

8. Employment agencies whose sole business is placing teachers or other school employees or placing domestic servants or unregistered nurses, G.S. 105-90 and 105-90.1. The former tax was $25.00.

9. Manufacturers and wholesale distributors of ice cream and similar frozen products, G.S. 105-97. The former tax was $1.50 per continuous freezer gallon capacity and $5.00 per non-continuous freezer gallon capacity, with a minimum of $10.00. The new tax rate is the same, but the minimum tax is increased to $50.00.

10. Cooperative associations, G.S. 105-102.1. The former tax was $10.00.

CONSOLIDATED PRIVILEGE LICENSE TAXES

The privilege license taxes listed below were consolidated in G.S. 105-102.5 into a single general business license having a tax of $50.00. The previous tax for any one of these privilege licenses ranged from $5.00 to $30.00.

The general business license replaces the privilege licenses listed below and permits a person to engage in any of the listed activities. Previously, a person who engaged in all of these activities was required to pay a separate privilege license tax for each activity. The general business license preserves any exemptions that previously applied to the separate licenses as well as any limitations on the adoption of local privilege licenses on the same activity.

The privilege license taxes that were consolidated into a single license tax are the taxes that were levied on:

(1) Those engaged in selling, leasing, or providing movies shown where no admission fee is charged or at a school, former G.S. 105-36.

(2) Bicycle dealers, former G.S. 105-49.

(3) Retail dealers in office equipment, home appliances, or alarms, former G.S. 105-51.

(4) Campground operators, former G.S. 105-61.1.

(5) Pool table operators, former G.S. 105-64.

(6) Bowling alley operators, former G.S. 105-64.1.

(7) Those who sell sandwiches, operate fewer than five vending machines, operate a soft drink stand, or sell tobacco products, former G.S. 105-65.2.

(8) Merry-go-round operators, former G.S. 105-66.

(9) Those engaged in selling or repairing pianos, organs, stereos, tape players, and other audio equipment, former G.S. 105-82.

(10) Retail ice cream dealers, former G.S. 105-97(c).

REPEALED PRIVILEGE LICENSE TAXES

The following license taxes were repealed:

(1) Checking attendance at a movie or show, former G.S. 105-36. This tax was repealed because no one has applied for the license in years and the tax therefore produced no revenue.

(2) Sundries license for those operating five or more closed-container soft drink vending machines, former G.S. 105-65.2(g). This tax was repealed because operators of

closed-container soft drink vending machines pay a flat license tax of $100.00 plus a per drink machine tax of approximately $7.00 per machine under G.S. 105-65.1.

1989 Chapter 605 (House Bill 800, Rep. Don Beard)

AN ACT AUTHORIZING THE APPOINTMENT OF A SPECIAL BOARD OF EQUALIZATION AND REVIEW FOR CUMBERLAND COUNTY.

Effective upon ratification, this act authorizes the Cumberland County Commissioners to appoint a Special Board of Equalization and Review. The Board will consist of five to nine members with authority to sit in as many as three three-member panels during revaluation years. The Commissioners may delegate to the Board the authority to make changes in tax records, compromise discoveries, and approve releases and refunds at any time in a calendar year.

1989 Chapter 615 (House Bill 1383, Rep. Bob Hunter)

AN ACT TO RECOGNIZE BONA FIDE ESTATE SETTLEMENTS FOR INHERITANCE TAX PURPOSES.

This act requires inheritance taxes to be assessed on the basis of a settlement agreement made by two or more persons who contest the distribution of a decedent's property under a will. Without the act, inheritance taxes would be assessed on the basis of who was given the property by the will rather than on who actually received the property under the settlement agreement. The act thus conforms North Carolina law to federal law on the subject of recognizing settlements in determining the amount of estate or inheritance tax due. The act applies to the estates of decedents dying on or after October 1, 1989.

Before a settlement is used to determine the amount of inheritance tax due, however, the taxpayer must prove to the Secretary of Revenue that the settlement was made in good faith to resolve an actual controversy over the distribution of a decedent's property and was not made for the purpose of avoiding taxes. A taxpayer who disagrees with the Secretary's determination of whether the settlement was a "good faith" settlement can appeal the determination to court.

The amount of inheritance tax due on the transfer of property by a decedent depends on to whom the property is given. Transfers to some recipients, such as a spouse or a charity, are exempt from inheritance tax. Transfers to other recipients are taxed at varying rates depending on the relationship of the recipient to the decedent. Transfers to a child, for example, are taxed at a lower rate than transfers to an unrelated friend.

Under prior law, if a will gave all of a decedent's property to the decedent's children and none to the decedent's spouse, inheritance tax would be assessed on all the property at the rate applicable to transfers to the children even if the children and the spouse entered into a settlement agreement that gave part of the property to the spouse. Under this act, the part of the property transferred to the spouse under the settlement agreement would be exempt from tax.

The act does not affect the determination of inheritance tax due when a court decision directs how property is to be distributed. In that circumstance, inheritance tax is payable based on who receives property under the decision. The act avoids the necessity of having a court decision, however. The persons who dispute the distribution made by the will can settle the dispute outside of court and have the settlement determine the amount of tax payable.

1989 Chapter 628 (Senate Bill 786, Senator Paul Smith)

AN ACT TO ALLOW THE DEPARTMENT OF REVENUE TO PROVIDE IDENTIFICATION INFORMATION FROM TAX RETURNS TO THE DEPARTMENT OF STATE TREASURER FOR ESCHEATS PURPOSES AND TO CLARIFY THE PURPOSE FOR WHICH THE EMPLOYMENT SECURITY COMMISSION MAY REQUEST IDENTIFICATION INFORMATION FROM THE DEPARTMENT OF REVENUE.

Effective upon ratification, this act allows the Department of Revenue to furnish to the Department of State Treasurer the names, addresses, and account and identification numbers of taxpayers who may be entitled to property held in the Escheat Fund when the Treasurer requests the information for the purpose of administering the Escheat Fund.

An escheat occurs when a property owner dies with no heirs or when the property is determined to be abandoned. Under prior law, property that might be placed in the hands of the owners could not be distributed by the State Treasurer for want of sufficient addresses or other identifying information.

The act also allows the Department to furnish to the Employment Security Commission the names, addresses, and account and identification numbers of taxpayers for the purpose of administering unemployment insurance.

1989 Chapter 667 (House Bill 556, Rep. Alex Hall)

AN ACT TO AUTHORIZE THE SECRETARY OF REVENUE TO ENTER INTO COOPERATIVE AGREEMENTS WITH OTHER STATES TO ADMINISTER THE FUEL TAX AND TO MAKE A CONFORMING CHANGE TO THE DEFINITION OF MOTOR CARRIER.

Like Chapter 7 of the 1989 Session Laws and House Bill 603 of the 1989 Session, this act is a recommendation of the Working Group on State Truck Issues established by the National Governor's Association. The Working Group's recommendations aim at simplifying the reporting requirements of interstate motor carriers.

Effective July 24, 1989, this act permits the Secretary of Revenue to enter into a "base state compact" with other states concerning administration of the motor carrier road tax, also called the motor fuel use tax, levied under Article 36B of Chapter 105 of the General Statutes. The road tax is levied on the amount of fuel used by a motor carrier in its operations in this State and is levied at the same rate as the excise tax on motor fuel purchased in this State. A credit is allowed against the road tax for the amount of tax paid on fuel purchased in this State. Thus, only motor carriers who drive in this State and do not purchase in this State the amount of gas used in driving in this State have a net road tax liability.

The act states that an agreement can specify the method for determining the base state for a motor carrier, set recordkeeping and audit requirements, set penalties and interest rates, permit the exchange of taxpayer information among the member states, and determine a method by which the base state will collect and distribute all road taxes or motor fuel use taxes due the member states in which the motor carrier operates. The agreement cannot change the amount of any tax or fee payable to this State by a motor carrier, however.

The act changes the definition of "motor carrier" used in the motor vehicle laws to match the changes made to that term in the tax laws by Chapter 7 of the 1989 Session Laws. Chapter 692 of the 1989 Session Laws, however, repeals the change made by this act in the definition

of "motor carrier" because it repeals the "decal" fee effective January 1, 1990, to which the definition applies.

1989 Chapter 674 (Senate Bill 1146, Senator Ollie Harris)

AN ACT TO CLASSIFY FOR PROPERTY TAXATION PRECIOUS METALS USED BY MANUFACTURERS AS MACHINERY.

Pursuant to the power granted the General Assembly in Article V, 2(2) of the North Carolina Constitution, this act designates certain precious metals as a special class of property and directs how they are to be assessed for property taxation. The act is effective for taxable years beginning on or after January 1, 1989. Although it is a statewide act, it currently affects only Cleveland and Davidson Counties because these counties are the only ones with these metals.

The metals affected are precious metals used or held for use directly in manufacturing or processing by a manufacturer as part of industrial machinery. These metals are taxed at the lower of their market value and their original cost less depreciation. To determine original cost less depreciation, the index factor, if any, that is used in assessing the related industrial machinery must be applied, the depreciable life of the metals is considered the same as the life assigned to the related industrial machinery, and the residual value of the metals may not exceed 25% of the manufacturer's original cost. Without this act, it was unclear how these metals should be assessed.

An owner of precious metals classified by this act must apply for the tax benefit granted by the act. In 1989, an owner can file an application any time before September 2. In subsequent years, an owner must file an application within the regular listing period. Once an owner of precious metals has applied for this benefit and the application has been approved, however, the owner continues to receive the benefit in subsequent years without having to reapply as long as the precious metals, or subsequently acquired precious metals, are used in the manufacturing process.

1989 Chapter 682 (Senate Bill 566, Senator Alexander Sands)

AN ACT TO REPEAL THE REQUIREMENT THAT LIENHOLDERS OF RECORD FILE A REQUEST IN ORDER TO RECEIVE NOTICE OF AN IN REM TAX FORECLOSURE.

Effective October 1, 1989, and applicable to foreclosure proceedings begun on or after that date, this act requires a county tax collector to notify all lienholders of record who have a lien against the listing taxpayer or against any subsequent owner of the property of a pending in rem tax foreclosure action against the property under G.S. 105-375. Under prior law, the tax collector was required to notify only those lienholders who had specifically requested that they be notified.

1989 Chapter 692 (House Bill 399, Rep. Bob Hunter)

AN ACT TO ESTABLISH THE NORTH CAROLINA HIGHWAY TRUST FUND, TO PROVIDE REVENUE FOR THE FUND, TO DESIGNATE HOW REVENUE IN THE FUND IS TO BE USED, AND TO RAISE REVENUE FOR THE GENERAL FUND.

(As amended by Chapters 700, 770, 788, and 799)

This act is the principal revenue-raising legislation of the 1989 Session. It raises revenue for both the General Fund and a 13 1/2 year, $9.1 billion highway program that it establishes. Under the act, the General Fund receives new revenue from four sources: an increase in the sales tax cap on the sale of a boat, an aircraft, a railway car, or a locomotive from $300.00 to $1,500 effective August 1, 1989; an increase in the estimated individual income tax reporting threshold from 80% to 90% effective for taxable years beginning on or after January 1, 1990; an increase in the short-term rental rate for motor vehicles from 2% to 8% effective October 1, 1989; and a transfer in fiscal years 1989-90 and 1990-91 of part of the increased revenue from a new "highway use" tax.

To implement the highway program, the act creates the North Carolina Highway Trust Fund, raises taxes and fees to provide revenue for the Fund, and specifies the programs for which Trust Fund revenue must be used. The act generates revenue for the Trust Fund by increasing the motor fuel tax by 5.2¢ a gallon, increasing the fee for issuing a certificate of title from $5.00 to $35.00, increasing related title fees from varying amounts to $10.00, and replacing the 2%, $300.00 maximum sales tax on motor vehicles with a 3%, $1,000 maximum "highway use" tax payable whenever a certificate of title for a motor vehicle is issued. The Trust Fund projects consist of the Intrastate System, seven urban loops, a supplement to cities for city streets, and a supplement for secondary road construction.

The Trust Fund is administered by the Department of Transportation and monitored by the Joint Legislative Highway Oversight Committee, which is created by the act. The Trust Fund is separate from the Highway Fund. Like the Highway Fund, however, the Trust Fund is subject to the Executive Budget Act. The Trust Fund and the tax and fee increases that are sources of revenue for the Fund terminate when the projects of the Trust Fund are completed.

In addition to the primary purposes of raising revenue for the General Fund and creating the Highway Trust Fund, the act makes numerous other changes in the law. For example, it establishes a 10% goal for minority participation in highway construction contracts, establishes a distribution formula for funds spent on the Intrastate System projects of the Trust Fund and on highway construction under the Transportation Improvement Program, requires all steel and cement permanently incorporated into highway construction projects to be produced in the United States, repeals the motor carrier "decal" fee, and provides a credit against the equipment use tax for taxes paid in another state. The many changes are described in the following detailed explanation of the act.

EXPLANATION OF HOUSE BILL 399, CHAPTER 692 OF THE 1989 SESSION LAWS

(As amended by Chapters 700, 770, 788, and 799 of the 1989 Session Laws)

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Summary

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Section by Section Analysis

Section 1.1: This section establishes the North Carolina Highway Trust Fund, specifies the sources and uses of the Fund, and requires the Department of Transportation to develop completion schedules for the Trust Fund projects.

G.S. 136-175. This provision defines Intrastate System, Transportation Improvement Program, and Trust Fund.

G.S. 136-176. This provision creates the Trust Fund, specifies the Fund's sources of revenue. designates the purposes for which revenue in the Fund is to be used, and specifies the percentage of Trust Fund revenue that is to be applied to each purpose. Trust Fund revenue consists of revenue received from the following:

(1) A motor fuel tax increase of 5.2¢ per gallon.

(2) The levy of a 3%, $1,000 maximum titling tax on the issuance of a certificate of title for a motor vehicle. (The act calls this tax a "highway use" tax).

(3) Revenue from title fee increases.

(4) Revenue made available by the retirement of highway refunding bonds.

(5) Interest on the Fund.

Trust Fund revenue is applied to the following purposes:

(1) Intrastate System- (61.95%).

(2) Urban loops-- (25.05%)

(3) Supplement to municipalities ("Powell Bill")-- (6.5%).

(4) Supplement for secondary roads-- (6.5%), plug $15 of the $30 increase in the fee for issuing a certificate of title. (See G.S. 20-85(b) in Section 2. 1. of this act.).

(5) Expenses of the Department of Transportation in administering the Trust Fund, not tb exceed 5% of the revenue collected from the motor fuel tax, highway use tax, and title fee increases. The percentage for expenses is calculated and subtracted before the four project percentage allocations are made.

(6) Expenses of the Joint Legislative Highway Oversight Committee- actual expenses are deducted from the amount allocated to the Intrastate System projects. (See G.S. 120-70.52 in Section 1.2 of this act.)

G.S. 136-177. This provision limits the amount of Trust Fund revenue that can be spent on highway construction for the next five fiscal years. Federal revenue and Trust Fund revenue used to supplement either the "Powell Bill" appropriation or secondary road construction are not counted in applying this dollar limitation. The amount that exceeds the limitation can be used only for preliminary planning and design and the acquisition of rights-of-way for Trust Fund projects.

G.S. 136-178. This provision describes the Intrastate System and permits the Department of Transportation to add routes to the System if the routes are built in accordance with the standards for the System.

G.S. 136-179. This provision lists the 32 projects of the Intrastate System that are to be funded from the Trust Fund. For each project listed, the provision indicates the counties that are affected by the project. The projects are listed in numerical order by road type. The projects primarily consist of widening and improving existing Interstate, U.S., and N.C. routes.

G.S. 136-180. This provision lists the seven urban loops that are to be funded from the Trust Fund. The loops are listed in alphabetical order by city. The seven loops are for the cities of Asheville, Charlotte, Durham, Greensboro, Raleigh, Wilmington, and Winston-Salem.

G.S. 136-181. This provision requires Trust Fund revenue used to supplement the "Powell Bill" appropriation to municipalities for city streets to be distributed the same way as that appropriation, which is by population. This supplement is in addition to the appropriation in G.S. 136-181 of the equivalent of a 1 3/4 per gallon tax on motor fuels. Like that appropriation, this supplement is distributed on October I of each year and is based on the amount collected during the fiscal year ending the preceding June 30. Cities will therefore not receive a Trust Fund supplement until October of 1990 because no Trust Fund revenue was collected during the 1988-89 fiscal year.

G.S. 136-182. This provision states the purpose of the secondary road supplement made from the Trust Fund, which is to pave in the next ten years all unpaved, state-maintained secondary roads traveled by at least 50 vehicles a day. It provides that the supplement is to end when the Department of Transportation certifies that all unpaved, state-maintained secondary roads can be paved in the next six years with non-Trust Fund revenue. This supplement is in addition to the allocation for secondary roads of the equivalent of a 1 3/4 per gallon tax on motor fuels. That allocation is made on the basis of anticipated revenues; therefore, secondary roads will receive a Trust Fund supplement in fiscal year 1989-90.

G.S. 136-183. This provision credits to the Trust Fund. rather than the Highway Fund, money that will become available in fiscal year 1994-95 and subsequent fiscal years from the retirement of highway refunding bonds. The amount increases a few years and then levels off at $38 million when all principal and interest payments on the bonds have been made.

G.S. 136-184. This provision requires the Department of Transportation to make completion schedules for the projects funded from the Trust Fund and to submit annual progress reports on the projects to the Joint Legislative Highway Oversight Committee. It further requires the Department to submit to that Committee any information the Committee needs to determine whether the expenditures from the Trust Fund and the Highway Fund comply with the new distribution formula in G.S. 136-17.2A.

Section 1.2. This section establishes the Joint Legislative Highway Oversight Committee. The Committee consists of 16 legislators, eight appointed by the Speaker of the House of Representatives and eight appointed by the President Pro Tempore of the Senate. Three of the Speaker's appointees must be members of the minority party, and two of the President Pro Tempore's appointees must be members of the minority party. The Committee is funded from Trust Fund revenue allocated for the Intrastate System and is to monitor both Trust Fund and Highway Fund revenues and expenditures and the progress on the Trust Fund projects.

Section 1.3. This section requires the Department of Transportation to submit a proposed Transportation Improvement Program. or proposed interim changes to a Transportation Improvement Program, to members of the Joint Legislative Highway Oversight Committee and a few other listed legislators and staff at least 30 days before the Board of Transportation approves the Program or the interim changes. (Section 74.16 of Chapter 770 changes the 25-day period in Chapter 692 to a 30-day period.)

Section 1.4. This section creates new G.S. 136-1 7.2A, which establishes a distribution formula for Trust Fund revenue spent on the Intrastate System and for revenue spent under the Transportation Improvement Program, other than revenue spent on an urban loop. The formula is designed to ensure that every region in the State receives its fair share of the transportation improvements. The formula divides the State into seven regions by grouping two of the existing 14 highway engineering divisions into a region. The statute lists the counties that are in each region.

Until 90% of the mileage of Intrastate System projects is completed, each region must receive between 90% and 110% of the total amount expended during any consecutive seven-year period multiplied by a factor that is based on the following components and weights: estimated miles to complete the Intrastate System projects in the region compared to the estimated miles to complete the Intrastate System projects in the State, weighted 25%; population of the distribution region compared to the population of the State, weighted 50%; and the fraction one-seventh. weighted 25%. When 90% of the mileage of the Intrastate System projects is completed, the factor by which the amount expended is multiplied changes

to have only two components as follows: population of the distribution region compared to the population of the State, weighted 66%; and the fraction one-seventh, weighted 34%.

Although each distribution region receives an equal share over time, each county within a distribution region may not necessarily receive the same amount as all other counties in the distribution region. The statute, however, directs the Department of Transportation to consider the highway needs of every county in a distribution region.

Section - 1.5. This section amends G.S. 136-28.4 to set a 10% goal for minority participation in construction contracts let by the Department of Transportation. The goal applies to all construction contracts let by the Department, not just the contracts for the Trust Fund projects. The goal is not a quota and parallels the 10% minority participation goal established by the federal government for federal highway contracts.

Section 1.6. This section directs how the Trust Fund supplement for city streets is to be distributed among the cities. Trust Fund revenue is distributed on the same basis as the "Powell Bill" appropriation of motor fuel tax revenue, which is by population.

Sections 1.7 and 1.8. These sections specify how the Trust Fund supplement for secondary roads is to be used. They require the first $68.67 million of the revenue allocated to secondary roads from the Highway Fund and Trust Fund to be distributed on the basis of the formula in G.S. 136-44.5, which contains a two factor formula based on population and unpaved miles, and require the remainder to be distributed based on the number of unpaved miles traveled by at least 50 vehicles a day. The sum "$68.67 million" is the amount of the existing allocation for secondary roads. In effect, all the Trust Fund supplement is applied to paving secondary roads traveled by at least 50 vehicles a day.

Section 1.9. This section prohibits the Department of Transportation from removing a secondary road that is on the list of the top ten roads to be paved by the Department in a county until the road is paved.

Section 1.10. This section requires the Department of Transportation to include in, or include in a document published with, a Transportation Improvement Program a list of any changes made in the previous year's Transportation Improvement Program.

Section 1.11. This section directs the Department of Transportation to make a toll study and determine on which ferries, roads, or bridges, if any, it is desirable to establish tolls. It requires the Department to report its findings to the General Assembly but does not set a date by which the Department must make its report.

Section 1.12. This section authorizes the Legislative Research Commission to study the long-range transportation needs of the state, including alternatives to highway construction.

Sections 1.13, 1.14, 1.15, and 1.16. These sections amend the gasoline tax, special fuel (diesel) tax, and motor carrier tax statutes to separate Trust Fund revenue from Highway Fund revenue. They require 75% of the revenue collected from the fuel taxes to be deposited in the Highway Fund and 25% to be deposited in the Trust Fund. These percentages were chosen because the 5.2¢ increase in the motor fuel tax is approximately 25% of the total motor fuel per gallon tax.

As amended by Chapter 788 of the 1989 Session Laws, Section 1.14 limits the Wildlife Resources Commission's percentage share of gasoline tax revenue to the amount deposited in the Highway Fund but, effective July 1, 1990, increases the amount of the percentage share from 1/8 of 1% to 1/6 of 1%. This change compensates the Wildlife Resources Commission for not receiving a share of the Trust Fund revenue.

Section 1.17. This section is a transitional provision that appropriates $11 million to the Department of Transportation for fiscal year 1989-90 for its expenses incurred in implementing the Trust Fund. Without this provision, the 5% limit for expenses in G.S. 136-176(b) would apply.

Section 1.18. This section adds a new G.S. 136-28.7 to require all steel and cement permanently incorporated into highway and bridge construction projects to be produced in the United States, unless the Department of Transportation finds that the products are not produced in the United States or cost too much. Note that Sections 74.12, 74.14, and 74.15 of Chapter 770 of the 1989 Session Laws all amend this section.

Section 2. 1. This section increases various title fees and allocates part of the fee increases for secondary roads. It increases the fee for issuing a certificate of title from $5 to $35 and increases related fees, such as the fee for recording a lien, to $10. It also directs that $15 of the $30 fee increase for issuing a certificate of title be added to the Trust Fund supplement for secondary roads. Five dollars of the $35 fee remains in the Highway Fund and the rest of the revenue from the $35 fee and all the revenue from the $10 fees is deposited in the Trust Fund. The fee increases are effective August 15. (The act sets an August I effective date. but Chapter 700 of the 1989 Session Laws changes the date to August 15.)

Section 2.2. This section increases the fee for one-day title service from $25 to $50, effective August 15, and requires the fee to be paid in cash or by certified check.

Section 2.3. This section amends G.S. 136-44.20 to permit the Department of Transportation to use up to $5 million of the amount appropriated each year for State construction to develop economical transit alternatives to highway construction.

Section 3.1. This section increases the sales tax cap on boats, aircraft, railway cars, and locomotives from $300 to $1,500, effective August 1, 1989. It does not affect the sales tax rate, which remains at 2%.

Section 3.2. This section distinguishes manufactured homes from motor vehicles so that manufactured homes are not affected by the changes in the taxation of motor vehicles made by this act. Under prior law, a manufactured home was considered a motor vehicle for sales tax purposes. Manufactured homes continue to be taxed under the sales tax at the rate of 2% with a $300 cap.

Sections 3.3 through 3.6. These sections exempt motor vehicles from sales tax, effective October 1, 1989. and allow a credit against the equipment use tax for taxes paid in another state. Motor vehicles are exempted from sales tax because they are subject to the new "highway use" tax levied in Section 4.1 of this act. The equipment use tax credit is the same as was recommended by the Revenue Laws Study Committee and introduced as House Bill 58. The sales tax cap of $1,500 on boats, aircraft, railway cars, and locomotives established in Section 3.1 of this act is preserved by Section 74.4 of Chapter 770 of the 1989 Session Laws.

Sections 3.7. through 3.10. These sections make technical changes to the local sales and use tax statutes and acts to make those statutes and acts conform to the revised structure of the sales tax statutes. These sections make no substantive changes.

Section 4.1. This section enacts a new Article 5A in Chapter 105 of the General Statutes. The new Article levies a titling tax, called a "highway use" tax, on the issuance of a certificate of title for a motor vehicle. The titling tax replaces the 2%, $300 maximum sales tax on motor vehicles.

G.S. 105-165. This provision applies the sales tax definitions to the highway use tax and defines Commissioner of Motor Vehicles and Division of Motor Vehicles.

G.S. 105-166. This provision states the nature of the tax levied by the new Article. The tax is a privilege tax on the privilege of using the highways of this State.

G.S. 105-167. This section sets the rate of the highway use tax. The rate is 3% of the retail value of the vehicle for which a title is issued. The tax cannot be less than $40, cannot exceed $1,000 until July 1, 1993. and cannot exceed $1,500 after that date. The retail value of a vehicle is determined as follows:

(1) New vehicle-- value is the sales price, less the amount of any trade-in allowance.

(2) Used vehicle sold by a dealer-- value is the sales price, less the amount of any trade-in allowance.

(3) Used vehicle sold by a person who is not a dealer-- value is presumed to be the wholesale book value of the vehicle. A person who disagrees with the presumed value must pay the tax due based on the presumed value, but may appeal the value to the Commissioner of Motor Vehicles in accordance with new G.S. 105-174.

(4) Vehicle transferred for a reason other than a sale of the vehicle, such as a gift-- value is presumed to be the wholesale book value of the vehicle. A taxpayer who disagrees with the presumed value must pay the tax due based on the presumed value, but may appeal the value to the Commissioner of Motor Vehicles in accordance with new G.S. 105-174.

G.S. 105-168. This section states how the highway use tax is collected. The tax is collected by the Commissioner of Motor Vehicles when a title is issued. A motor vehicle dealer can collect the tax due and remit the tax when applying for a certificate of' title on behalf of the purchaser of a vehicle. The tax must be paid, however, before a title can be issued.

G.S. 105-169. This section provides an alternate gross receipts tax for lessors and renters of motor vehicles. It gives those who lease or rent motor vehicles the option of paying the highway use tax when they purchase a vehicle for lease or rent or of paying a tax on the gross lease or rental receipts subsequently received when the vehicle is leased or rented. The optional tax on gross receipts is 8% on leases or rentals to the same person for no more than 90 days, and it is 8% for the first 90 days of a lease or rental to the same person for more than 90 days and 3% for the period in excess of 90 days. The maximum highway use tax applies to lease or rental receipts, but the maximum is computed anew on each lease or rental of the vehicle to a different person. The optional tax is collected by the Department of Revenue instead of the Commissioner of Motor Vehicles in the same manner as sales and use taxes are collected under Article 5 of Chapter 105 of the General Statutes.

The option of paying a gross receipts tax applies to vehicles purchased on or after October 1, 1989, the effective date of the tax change, it does not apply to vehicles owned on that date. The lease or rental of vehicles owned as of October 1 is subject to the new 8% short-term and 3% long-term rates, and the lessor or renter does not have the option on October 1 of paying a use tax on the vehicles rather than charge the new rates. The change, however, applies only to leases oi- rentals made on or after October l. Therefore, the change does not affect a long-term lease in effect on October 1, for example, until the lease is renewed.

G.S. 105-170. This section sets the full and partial exemptions from the highway use tax. Two types of title transactions are exempt, several are subject to only the $40 minimum tax, and out-of-state vehicles titled in this State have a special $100 maximum. The sales tax exemptions and refund provisions do not apply to the highway use tax. Therefore. the local

governmental entities and the nonprofit organizations that receive refunds of sales taxes do not receive refunds of the highway use tax.

The two types of transfers of title that are exempt from the new highway use tax are titles for wrecked vehicles transferred to an insurance company and titles transferred to a motor vehicle dealer when the car is to be sold by the dealer. Section 74.9 of Chapter 770 of the 1989 Session Laws adds the second of these exemptions.

The transfers that are subject to only the $40 minimum tax are: gifts between spouses or a parent and child, transfers by will or intestacy, distributions of marital property, transfers to a person who has a lien on the transferred motor vehicle, Internal Revenue Code § 351 or 721 transfers to a partnership or corporation upon the formation of the entity or to a corporation upon the merger or consolidation of the corporation with another entity. and transfers to (he same owner to reflect a change in the owner's name. These transfers are considered partial exemptions because they are subject to the $40 minimum.

Titles issued for vehicles of out-of-State residents who move to this State have a maximum tax of $100. This maximum applies to titles issued to motor vehicles that have previously been titled in another state for at least 90 days.

G.S. 105-171. This section provides a credit against the highway use tax for sales tax or any similar tax paid to another state on the out-of-state purchase of a motor vehicle that is titled in this State within 90 days after it is purchased. If the tax paid to the other state is less than the amount of highway use tax payable upon the titling of the vehicle in this State, the owner must pay the difference to the Commissioner of Motor Vehicles before a title can be issued.

G.S. 105-172. This section allows a refund of all but the minimum $40 highway use tax paid on a purchased motor vehicle that turns out to be a "lemon. " To obtain a refund, the "lemon" must be returned within 90 days after it was purchased and the buyer must have received either a refund of the purchase price or a replacement of the vehicle. An application for a refund must be filed with the Commissioner of Motor Vehicles within 30 days after receiving the refund or the replacement vehicle.

G.S. 105-173. This section directs the disposition of revenue from the highway use tax and the optional gross receipts tax. All revenue from the highway use tax is deposited in the Highway Trust Fund. Revenue from the optional gross receipts tax is placed in the Trust Fund if it is at the 3% rate and is placed in the General Fund if it is at the 8 % rate. Generally, therefore, revenue from long-term leases or rentals is deposited in the Trust Fund. and revenue from short-term leases or rentals is deposited in the General Fund.

Part of the revenue deposited in the Trust Fund is transferred to the General Fund each year. The amounts transferred in fiscal years 1989-90 and 1990-91 are set out in Section 4.3 of this act ($279.4 million for 1989-90 and $356 million in 1990-91). In subsequent fiscal years, $170 million is transferred to the General Fund. The amount of $170 million was chosen because it is the amount of sales tax revenue the General Fund received from the sale of motor vehicles before the repeal of the sales tax on motor vehicles.

G.S. 105-174. As amended by section 74.8 of Chapter 770 of the 1989 Session Laws, this section sets out the penalties and remedies applicable to the highway use tax. It imposes a 10% penalty for bad checks offered in payment of the highway use tax, gives the Division of Motor Vehicles the same collection remedies that apply to other taxes collected by the Division. and establishes an appeal procedure.

To appeal the presumed value of a vehicle, the taxpayer disputing the value must provide two independent estimates of the motor vehicle's value to the Commissioner of Motor Vehicles. If the Commissioner agrees with the taxpayer, the taxpayer receives a refund of any overpayment of tax with interest from the date the tax was paid.

Section 4.2. This section raises the maximum highway use tax from $1,000 to $1,500 effective July 1, 1993.

Section 4.3. This section specifies how much Trust Fund revenue is to be transferred to the General Fund in this biennium. The amount of the transfers are:

1989-90 fiscal year-- $279 million.

1990-91 fiscal year-- $356 million.

Section 5.1. Effective August 1, 1989, this section increases the fuel tax by a flat Y per gallon plus 4% of the average wholesale price and mandates that the percentage component of the gas tax cannot be less than 3 1/2¢. The prior tax rate was a flat rate of 14¢ per gallon plus 3% of the average wholesale price. Before the increase the tax was 15.7¢ a gallon, after the increase the tax was 20.9¢ a gallon. The tax therefore increased by 5.2¢ a gallon.

Section 5.2. This section amends the statute that permits those who buy motor fuel for a purpose other than driving on the highway to get a refund of the tax paid on the fuel, less 1¢ a gallon. The section increases the refund rate to the new tax rate, less 1¢.

Section 5.3. This section amends the statute that permits The Department of Transportation, counties, cities, volunteer rescue squads, volunteer fire departments, and sheltered workshops to receive a tax refund of the motor fuel tax paid on fuel used by them, less 1¢ a gallon. The section increases the refund rate to the new tax rate, less 1¢.

Section 5.4. This section amends the statute that permits taxis and transit system buses to receive a refund of the motor fuel tax paid on fuel used by them, less IC a gallon. The section increases the refund rate to the new tax rate, less 1¢.

Section 5.5. This section amends the statute that permits vehicles, like concrete mixers, that use fuel for a purpose other than to propel the vehicle to receive a partial refund of the motor fuel tax paid by them. It increases the refund rate to one-third of the motor fuel tax paid, less I C a gallon.

Section 5.6. This section amends the statute that permits those who purchase motor fuel that is transported outside the state to receive a refund of the amount of motor fuel tax paid by them on the fuel, less I C a gallon. The section increases the refund rate to the new tax rate, less I C.

Section 5.7. This section amends the statute that gives motor carriers a credit against their highway use tax, or road tax, liability for the amount of motor fuel tax paid on fuel purchased in this State. The highway use tax is a tax imposed on motor carriers at the rate of the gas tax. Those that drive only in this state pay no tax because they also buy their gas here and the tax paid on the gas offsets their liability for the highway use tax. Those that do not buy their gas here pay the highway use tax. Unlike the gas tax refunds described in the previous sections, the gas tax credit is for the full amount of the tax paid with no I c a gallon reduction.

Sections 5.8 through 5.13. These sections are transitional provisions that require those who have motor fuel on hand on the effective date of the gas tax increase to pay the difference in the old tax rate and the new tax rate. The provisions also set the quarterly and annual refund rates that apply to the first quarter and year following the increase. Annual refund claims are made on a calendar year and not a fiscal year basis.

Section 5.14. This section repeals a change to a motor carrier statute that was made earlier in the 1989 Session and conflicts with this act.

Sections 6.1 and 6.2. These sections repeal the nirrent $10 fee motor carriers must pay to register for payment of the road tax, which is also known as Ille highway use tax. The fee is repealed because fees similar to this fee have been held unconstitutional by the United States Supreme Court as a burden on interstate commerce.

Section 6.3. This section repeals a change made to the definition of motor carrier in G.S. 20-88.01 in a previous act of the 1989 Session. The changed definition has no application outside the repealed fee and is therefore unnecessary.

Section 7.1. This section raises the estimated individual income tax reporting threshold from 80% of the tax due to 90%. This change conforms to federal law. Effective with the 1990 tax year, a person who is required to make estimated individual income tax payments during the year must pay at least 90% of the amount due to avoid having to pay a penalty.

Section 8.1. This section makes it clear that the requirement imposed by the act that secondary roads remain on a priority list until paved applies to the list adopted for the 1988-89 fiscal year.

Section 8.2. This section preserves a taxpayer's and the State's rights to refunds and to the collection of taxes when a tax is repealed under this act.

Section 8.3. This section specifies when the parts of the act become effective. The increase in the sales tax on boats, airplanes. railway cars, and locomotives is effective August 1. The titling tax is effective October 1. The title fee increases are effective August 15 (by operation of Chapter 700). The gas tax increase is effective August 1. The income tax reporting change is effective for taxable years beginning on or after January 1, 1990. The road tax registration fee is repealed effective January 1, 1990. The Trust Fund provisions are effective August 1.

Section 8.4. This section sunsets the Trust Fund and the tax and fee increases made by the act when all contracts for the Trust Fund projects have been let and sufficient revenue has been accumulated to pay the contracts. When the revenue has accumulated, the Secretary of Transportation will certify that occurrence, and then the titling tax will be repealed and the sales tax on cars reinstated at the rate of 2% with a $300 cap. the gas tax increase will be repealed, the $35 title fee will be reduced to $10, the Trust Fund will be abolished, and the Joint Legislative Highway Oversight Committee will be abolished.

$170 Million Highway Trust Fund Transfer
Background Explanation

Prior to the enactment of the Good Roads Package in 1989, a sales tax was levied on the sale of motor vehicles. The proceeds of the tax went to the General Fund. During the last couple of years in which the tax was collected, the yield was around $170 million (almost no year-to-year growth).

The 1989 package converted the tax from a sales tax to a much-broader highway use tax and both the tax rate and tax limit per vehicle was raised. The proceeds of the tax are credited to the Highway Trust Fund. For the 1989-91 biennium, the full amount of the proceeds from the new tax was transferred to the General Fund. This was part of a budget agreement that resulted from concerns by school advocates that the “motor vehicles sales tax” belonged totally to the General Fund and highway advocates who felt that all of the new tax should remain with the Trust Fund.

For years after 1990-91 a flat $170 million was to be transferred to the General Fund. The idea was that this would be a full hold harmless to the General Fund for the loss of the revenue it formerly received from the sales tax on motor vehicles. No growth was provided because it was felt that the motor vehicle sales tax had not grown in the years leading up to 1989.

1989 Chapter 704 (House Bill 945, Rep. Pryor Gibson)

AN ACT TO EXEMPT VENTURE CAPITAL COMPANIES FROM INTANGIBLES TAX.

Effective for taxable years beginning on or after January 1, 1989, this act exempts venture capital firms from paying intangibles tax. A venture capital firm, as defined in this act, is a person, corporation, partnership, limited partnership, or other entity that meets all the following requirements:

(1) Invests in the securities of a company for the sole purpose of selling the securities in the future.

(2) Is not organized to make a permanent investment in one type of company.

(3) Is organized for the purpose of investing more than 50% of all its investments, other than its idle funds, in the equity securities or subordinated debt of companies that at the time of the investment:

   a. Had no more than 100 owners of their securities, excluding officers, directors, partners, and employees;

   b. Were not financial institutions; and,

   c. Did not derive their income or value primarily from real estate.

(4) Has the remainder of its investments in shares of stock or other investments on which no tax is either imposed or is payable under this Article.

A venture capital firm can rely on the written representations of a company as to the number of owners of its securities.

1989 Chapter 705 (House Bill 1775, Rep. Steve Wood)

AN ACT TO INCREASE THE MAXIMUM PROPERTY TAX EXCLUSION FOR RESIDENCES OF DISABLED VETERANS.

G.S. 105-275(21) allows a property tax exclusion for specially adapted housing (including land) owned and used by a disabled veteran receiving benefits under 38 U.S.C. 801. This act increases the maximum amount of the exclusion from $34,000 to $38,000 to bring it in line with the corresponding federal grant amount. The act is effective for taxable years beginning on or after January 1, 1990.

1989 Chapter 713 (Senate Bill 1163, Senator Russell Walker)

AN ACT TO PROVIDE THAT A PAID PREPARER OF TAX RETURNS MAY NOT DESIGNATE ON A TAXPAYER'S RETURN WHETHER OR NOT TAX FUNDS SHALL BE PAID FOR THE USE

OF POLITICAL PARTIES UNLESS THE PREPARER OBTAINS THE CONSENT OF THE TAXPAYER OR THE TAXPAYER'S SPOUSE.

G.S. 105-159.1 allows a taxpayer to designate on her or his income tax form that $1.00 of the amount of tax paid shall be used for the North Carolina Political Parties Financing Fund. This act provides that a paid preparer of tax returns, such as an accountant or attorney, may not make a designation on the return either for or against such use of the $1.00 unless the taxpayer or the taxpayer's spouse consents to the designation. The act is effective beginning with the 1989 tax year.

1989 Chapter 716 (Senate Bill 405, Senator J. K. Sherron)

AN ACT TO INCREASE THE MAXIMUM INCOME TAX CREDIT FOR DONATIONS OF REAL PROPERTY FOR LAND CONSERVATION.

Effective for taxable years beginning on or after January 1, 1989, this act increases both the maximum individual and the maximum corporate income tax credits allowed for certain donations of property from $5,000 to $25,000. The credit applies to property that is donated to a governmental entity or to a nonprofit conservation organization and can be used for public beach access, public access to public waters or trails, fish and wildlife conservation, or other similar land conservation purposes.

The credit allowed is 25% of the fair market value of the donated property, not to exceed $25,000. The credit cannot reduce the taxpayer's income tax liability below zero and any excess credit cannot be carried forward to subsequent years.

1989 Chapter 718 (Senate Bill 894, Senator George Daniel)

AN ACT TO ELIMINATE DOUBLE TAXATION OF INCOME IN RESPECT OF A DECEDENT.

This act allows a taxpayer to deduct from federal taxable income the amount of inheritance tax paid by the taxpayer on certain property, such as an installment note, that generates future income and an accompanying income tax. The deduction is allowed from federal taxable income because, with the enactment of Chapter 728 of the 1989 Session Laws, North Carolina personal income tax is a percentage of federal taxable income. Federal law allows a similar deduction for the amount of federal estate tax attributable to income-producing property. The act is effective for taxable years beginning on or after January 1, 1989.

The principle underlying this deduction is the avoidance of double taxation of the same property by both an inheritance tax and an income tax. Under prior law, a person who inherited an installment note or other type of property that represents a right to future income paid inheritance tax upon receiving the property and then paid income tax upon receipt of the income. This act eliminates this double taxation aspect by providing an income tax deduction for the amount of inheritance tax paid on the property.

1989 Chapter 723 (House Bill 457, Rep. Steve Wood)

AN ACT TO EXCLUDE FROM AD VALOREM TAXATION REAL AND PERSONAL PROPERTY OWNED BY NONPROFIT ORGANIZATIONS AND LEASED BY UNITS OF GOVERNMENT FOR PUBLIC PURPOSES.

This act exempts a limited category of property from property tax effective for taxable years beginning on or after January 1, 1989. It exempts property that is owned by a nonprofit corporation organized at the request of a local government unit for the sole purpose of financing projects for public use, is leased to the unit of government that requested the formation of the corporation, and is used for a public purpose. Once an owner of this type property applies for the exemption and the application is approved, the act relieves the owner of the duty of reapplying for the exemption in future years.

To enable property owners to take advantage of the exemption in 1989, the act permits an application for the exemption to be filed on or before September 1, 1989. Normally, applications for property tax exemptions must be filed during the regular listing period.

1989 Chapter 728 (Senate Bill 51, Senator Dennis Winner)

AN ACT TO ENHANCE THE SIMPLICITY AND FAIRNESS OF THE STATE INCOME TAX SYSTEM.

This act, the Tax Fairness Act of 1989, conforms the State individual income tax to the federal income tax law in order to simplify calculation of the tax, provide tax relief to low income taxpayers, and enhance the Department of Revenue's ability to enforce the law. The act revises the Individual Income Tax Act, effective with the 1989 tax year, to tax at the rates of 6% and 7% each taxpayer's taxable income, which is calculated as the individual's federal taxable income attributable to North Carolina, minus amounts that are exempt from State income tax, and plus amounts that are taxed by the State but not by the federal government. These revisions have the effect of modernizing the tax system and adjusting it for inflation by increasing personal exemptions and the standard deduction. As a result, taxes will be reduced for approximately 65% of low to moderate income taxpayers and increased to some extent for the remaining taxpayers. Tax exempt bonds and social security benefits will remain exempt from tax.

The act also authorizes married couples to file joint returns, makes conforming changes to the income tax provisions applicable to Subchapter S Corporations and estates and trusts, increases the child and dependent care tax credit from 7% to 10% for pre-school children and disabled dependents, and makes conforming changes to other parts of Chapter 105 of the General Statutes.

The act was amended by Chapter 792 of the 1989 Session Laws, discussed below, to exempt from tax $4,000 of state, local, and federal retirement benefits or $2,000 of private retirement benefits. Because this act will change the amounts of tax that should have been withheld or paid as estimated tax for 1989, it provides that no estimated tax penalty will be imposed for an underpayment for the 1989 tax year to the extent the underpayment is due to the changes made by the act. Recommended by the Tax Fairness Study Commission.

For a more detailed discussion of the Tax Fairness Act of 1989, see the following explanation:

EXPLANATION OF SENATE BILL 51, CHAPTER 728 OF THE 1989 SESSION LAWS

The Tax Fairness Act of 1989

Table of Contents

Part 1. Income Tax Reform.

A. Individual Income Tax Act Amendments.

B. S Corporation Income Tax Act Amendments.

C. Income Tax Act for Estates and Trusts Amendments.

D. Chapter 105 Conforming Amendments.

Part 11. Savings Clause and Effective Date.

Summary

Part I of the act revises the Individual Income Tax Act, effective with the 1989 tax year, to tax at the rates of six percent (6%) and seven percent (7%) each taxpayer's taxable income. which is calculated as the individual's federal taxable income attributable to North Carolina, minus amounts that are exempt from State income tax, and plus amounts that are taxed by the State but not by the federal government. Part I also authorizes married couples to file joint returns, makes conforming changes to the income tax provisions applicable to Subchapter S Corporations and estates and trusts, increases the child and dependent care tax credit for certain dependents, and makes conforming changes to other parts of Chapter 105 of the General Statutes.

Part 11 of the act provides the savings clause and effective dates for the bill. Because Part I will change the amounts of tax that should be withheld or paid as estimated tax for 1989, Part 11 provides that no estimated tax penalty will be imposed for an underpayment for the 1989 tax year to the extent the underpayment is due to Part I of the act.

Section by Section Analysis

Part I of the act reforms the individual income tax laws of this State. Subpart A of Part I rewrites the Individual Income Tax Act, Division 11 of Article 4 of Chapter 105 of the General Statutes. Sections 1. 1 and 1.2 make minor changes regarding the title and purpose of the Individual Income Tax Act. Section 1.3 repeals 23 statutes from current law that relate to definitions, tax rates, year of assessment, calculation of gross income and net income, deductions, and exemptions.

Section 1.4 adds nine new statutes to replace those deleted by Section 1.3. New § 105-134. 1, Definitions. modifies or deletes existing definitions and adds new definitions as necessary for the new law. The Internal Revenue Code referenced is the law as of January 1. 1989, but does not include provisions to automatically increase exemptions and standard deductions to keep up with inflation. Definitions from the Code are adopted by cross-reference.

New § 105-134.2 imposes the individual income tax as a percentage of each individual's North Carolina Taxable Income. which is federal taxable income adjusted as provided below. As in the federal law. there are separate brackets for married individuals filing joint returns and surviving spouses. heads of households, single individuals. and married individuals filing separate returns. The brackets are as follows:

Joint return	$0-21,25	6%
	Over $21.250	7%
Head of Household	$0- 17,000	6%

	Over $17,000	7%
Single	$0- 12,750	6%
	Over $12.750	7%
Separate return	$0- 10,625	6%
	Over $10,625	7%

New § 105-134.3, providing that the tax is paid in the year following the taxable year, is the same as current G.S. 105-137, repealed by Section 1.3 above. New § 105-134.4 requires taxpayers to use the same taxable year for State tax purposes as for federal tax purposes.

New § 105-134.5 defines North Carolina Taxable Income as federal taxable income adjusted as provided in new §§ 105-134.6 and 105-134.7. below. For nonresidents and part-year residents the amount is further adjusted to exclude income that is not attributable to North Carolina sources. For S Corporations and partnerships, corporate income apportionment formulas from the Corporation Income Tax Act' are used to determine the amount of income that is attributable to North Carolina.

New § 105-134.6 provides for adjustments to federal taxable income in calculating North Carolina Taxable Income. In subsection (a), certain S Corporation income is adjusted in the same way as corporate income under the Corporation Income Tax Act. In subsection (b), amounts are deducted if they are to be exempt from State income tax: interest on U.S.. North Carolina, and local government obligations; interest on and gain from the disposition of tax exempt obligations; retirement benefits under the Social Security Act and the Railroad Retirement Act; up to $1,500 received as compensation for national guard service; and refunds of State, local. or foreign income taxes included in the taxpayer's gross income. In subsection (c), amounts are added if they are exempt from federal- income tax but not State income tax: interest on obligations of other states and their political subdivisions-, income taxed under federal law separately from taxable income; State, local, and foreign income taxes; and automatic increases in federal exemptions and deductions.

New § 105-134.7 provides for adjustments to federal taxable income necessary to effect the transition from current law to the new State tax law enacted by the act. These adjustments relate to calculating the basis of property when it is transferred, recognizing gain that was previously unrecognized, carrybacks and carryforwards of net losses, and carryforwards of other losses and deductions. The section also authorizes the Secretary of Revenue to require other adjustments as necessary to avoid double taxation or unintended exemptions due to the transition from old to new law.

New § 105-134.8 is essentially the same as current G.S. 105-146. This statute authorizes the Secretary of Revenue to take inventories.

Sections 1.5-1.7. 1.9, 1.10, 1.12-1.15, and 1. 17-1.20 carry forward the following tax credits with conforming changes:

G.S. 105-15 1.	Tax credits for income taxes paid to other states by individuals.
G.S. 105-151.1.	Tax credit for construction of dwelling units for handicapped persons.
G.S. 105-151.2.	Credit for solar hot water, heating, and cooling.
G.S. 105-151.5.	Credit for conversion of industrial boiler to wood fuel.
G.S. 105-151.6.	Credit for construction of a fuel ethanol distillery.

G.S. 105-151.7. Credit for installation of a hydroelectric generator.

G.S. 105-151.8. Credit for installation of solar equipment for the production of industrial or process heat.

G.S. 105-151.9. Credit for installation of a wind energy device.

G.S. 105-151.10. Credit for construction of a methane gas facility.

G.S. 105-151.12. Credit for certain real property donations.

G.S. 105-151.13. Credit for conservation tillage equipment.

G.S. 105-151.14. Credit for gleaned crop.

G.S. 105-151.15. Credit for distributing North Carolina wine.

G.S. 105-151.17. Credit for creating jobs in severely distressed county.

Section 1. 16 modifies G.S. 105-15 1.11, Credit for child care and certain employment related expenses, to track the federal credit and increase the percentage of child care or dependent care expenses that is allowed as a credit from seven percent (7%) to ten percent (10%) for dependents that are under seven years old or are physically or mentally incapable of caring for themselves.

Sections 1.8, 1.11, and 1.21 of the bill repeal the following individual income tax credits:

G.S. 105-151.4. Credit against personal income tax for construction of cogenerating power plants.

G.S. 105-151.6A. Credit against personal income tax for construction of a peat facility.

G.S. 105-151.16. General credit for individuals with low or moderate incomes.

Section 1.22 adds two new tax credits to the Individual Income Tax Act: § 105-151.18, Credit for the disabled, and § 105-151.19, Credit for North Carolina dividends. The credit for the disabled allows a low-income or moderate-income person who is permanently and totally disabled and retired on disability income a tax credit of up to $250.00 if single or $375.00 if married filing a joint return. The credit for North Carolina dividends allows a credit equal to six percent (6%) of the amount of dividends received from corporations doing at least 50% of their business in North Carolina, up to a maximum credit of $300.00 if single or $600.00 for a married couple.

Section 1.23 amends G.S. 105-152 to make conforming changes, authorize joint returns, and authorize the Secretary to require taxpayers to attach a copy of their federal return to their State return. Section 1.24 adds a new § 105-152.1 to provide that a husband and wife may file a joint return tinder certain circumstances. Sections 1.25-1.27 and 1.29-1.32 make conforming changes to the following individual income tax statutes:

G. S. 105-154. Information at the source.

G.S. 105-155. Time and place of filing returns.

G. S. 105-156. Failure to file returns-, supplementary returns.

G. S. 105-157. Time and place of payment of tax.

G. S. 105-158. Abatement of income taxes of certain members of the armed

forces upon death.

G. S. 105-159. Corrections and changes.

G. S. 105-159.1. Designation of tax by individual to political party.

Section 1.28 repeals G.S. 105-156. 1, which was recodified as § 105-134.8, above.

Subpart B of Part I of the act amends the S Corporation Income Tax Act, Division I-S of Article 4 of Chapter 105 of the General Statutes, to conform to the rewrite of the Individual Income Tax Act. Sections 1.33 and 1.34 amend Chapter 1089 of the 1987 Session Laws to make conforming changes and to change that law's effective date of July 1, 1990, to January 1, 1989. Section 1.35 revises Division I-S to provide that State taxation of Subchapter S Corporations and their shareholders shall be done in the same way as under the Code, and to make conforming and technical changes.

Subpart C of Part I of the act, Sections 1.36-1.38, rewrites the Income Tax Act for Estates and Trusts. Division III of Article 4 of Chapter 105 of the General Statutes. to conform to the rewrite of the Individual Income Tax Act. Subpart D of Part I of the act, Sections 1.39-1.48, makes changes to cross-references in Chapter 105 needed because the provisions referenced were rewritten by the act and clarifies the language in these statutes.

Part 11 provides that the act is effective for taxable years beginning on or after January 1, 1989. It does not affect pending litigation. No penalty for underpayment of estimated taxes for 1989 will be imposed if the underpayment was due to the tax law changes contained in Part 1.

1989 Chapter 736 (House Bill 1397, Rep. Gene Wilson)

AN ACT TO PROVIDE SPECIAL RULES FOR USE VALUE TAXATION OF CHRISTMAS TREES.

Effective for taxable years beginning on or after January 1, 1990, this act changes the horticultural use value requirements for land used to produce evergreens intended for use as Christmas trees. The act directs the Department of Revenue to establish, with the assistance of the Use-Value Advisory Board, requirements for horticultural land used to produce Christmas trees that differ from the gross income requirements for other horticultural land.

Under prior law, all land qualifying for horticultural use value must have produced an average gross income of at least $1,000 for three years preceding January 1 of the year for which the benefit was claimed. Often, this requirement could not be met by horticultural land used for the production of evergreens intended for use as Christmas trees because of the income fluctuations that result from the lengthy and varied growth periods of evergreens.

The act directs the Department to establish a "qualifying requirement" in lieu of a "gross income requirement" to be used for horticultural land used to produce Christmas trees until the trees are harvested from the land. The Department is also directed to establish a new gross income requirement for this type of horticultural land, that differs from the income requirement for other horticultural land, to be used when the trees are harvested from the land.

1989 Chapter 748 (Senate Bill 1145, Senator Ted Kaplan)

AN ACT TO PROVIDE THAT SALES AND USE TAXES DO NOT APPLY TO THE LEASE OR RENTAL OF TOBACCO SHEETS AND TO PERMIT THE NEW HANOVER COUNTY AIRPORT AUTHORITY TO RECEIVE ANNUAL SALES AND USE TAX REFUNDS.

Tobacco sheets are burlap sheets used in handling tobacco in the warehouse and transporting tobacco to and from the warehouse. In order to alleviate a shortage of tobacco sheets, a corporation was formed to repair existing sheets, purchase new sheets, supply sheets to warehouses, and pick up sheets from warehouses and plants for redistribution. Warehouses, farmers, and purchasers of tobacco will pay a 25¢ fee for the use of each sheet in order to finance this supply system. This act provides that, effective August 1, 1989, sales and use taxes do not apply to the 25¢ fee for use of a tobacco sheet.

This act also contains a technical correction to the law authorizing the creation of a New Hanover County Airport Authority to clarify that the airport authority will be eligible for sales and use tax refunds to the same extent as a municipal corporation. The technical correction is effective upon ratification.

1989 Chapter 753 (Senate Bill 740, Senator Howard Bryan)

AN ACT TO AUTHORIZE THE NORTH CAROLINA DEPARTMENT OF REVENUE TO ENTER INTO AGREEMENTS WITH THE EASTERN BAND OF CHEROKEE INDIANS REGARDING REFUNDS OF MOTOR FUELS AND SPECIAL FUELS TAXES, TO INCREASE THE NUMBER OF COUNTIES ELIGIBLE FOR CLASSIFICATION AS A SEVERELY DISTRESSED COUNTY FROM TWENTY TO TWENTY-FIVE, AND TO PROVIDE ELIGIBILITY CRITERIA FOR TAX CREDITS FOR SEVERELY DISTRESSED COUNTIES.

Effective retroactively to January 1, 1985, this act authorizes the Department of Revenue to enter into a memorandum of understanding or an agreement with the Eastern Band of Cherokee Indians to make refunds of motor and special fuel taxes paid by the Indians for fuel purchased on the reservation. These refunds will be made to the Tribe on behalf of its members who reside on or engage in otherwise taxable transactions within Cherokee trust lands. Any agreement must be approved by the Tribal Council and signed by the Chief on behalf of the Tribe.

Individual members of the Tribe, however, remain entitled to a refund upon application. Amounts refunded to individual members of the Tribe are deducted from the amounts to be refunded to the Tribe. All refunds are charged to the Highway Fund.

The United States Supreme Court has ruled on numerous occasions that Indians and Indian property on an Indian reservation are not subject to state taxation unless Congress expressly grants this authority to the state. Congress has not granted North Carolina the authority to levy motor and special fuel taxes on the Eastern Band of Cherokee Indians, which is the only federally recognized Indian tribe in North Carolina. It should be noted, therefore, that refunding money to the Council on behalf of the members, or to individual members, does not preclude an individual member or members from bringing legal action against the State, based on the Constitution and federal statutes, to invalidate any State tax imposed on the sale of motor or special fuels to members of the Tribe on Cherokee trust lands.

Effective for taxable years beginning on or after January 1, 1989, this act also amends the law granting an income tax credit to a corporation or an individual who creates jobs in a severely distressed county. That credit is also amended by Chapter 111 of the 1989 Session Laws, discussed above.

The General Assembly created this income tax credit in 1987; it will expire for taxable years beginning on or after January 1, 1993. To be eligible for the credit, the individual or corporation claiming the credit must employ nine or more people for at least 40 weeks during the year and the business must be located in a severely distressed county. A taxpayer meeting these requirements may claim a $2,800 credit for each additional full time employee hired. The credit of $2,800 must be taken in equal installments over the four years following the year in which the additional employee was hired. The credit is conditioned on the continued employment of the number of employees the taxpayer had upon hiring the employee that caused the taxpayer to qualify for the credit.

Under prior law, the 20 counties with the highest distress factors were considered the "severely distressed counties." The act increases the number of severely distressed counties to the 25 counties with the highest distress factors. The distress factor is based upon the county's rate of unemployment and per capita income.

The act also establishes a third eligibility requirement for the tax credit. To be eligible for the tax credit, the taxpayer must have obtained this tax credit for taxable year 1988 or be engaged either in the manufacturing of goods or in an industrial activity.

1989 Chapter 769 (Senate Bill 50, Senator Dennis Winner)

AN ACT TO CLARIFY THAT INCOME DERIVED FROM DEPOSITS AT THE FEDERAL HOME LOAN BANK IS EXEMPT FROM STATE INCOME TAX.

Effective for taxable years beginning on or after January 1, 1989, this act exempts from income taxation the amount of interest earned by savings and loan associations on deposits they maintain at the Federal Home Loan Bank of Atlanta. To be eligible for this exemption, the savings and loan association must meet the qualified thrift lender test set forth in the federal Financial Institutions Reform, Recovery and Enforcement Act of 1989 (Pub. L. No. 101-73).

1989 Chapter 772 (Senate Bill 699, Senator Bob Shaw)

AN ACT TO IMPOSE AN EXCISE TAX ON CONTROLLED SUBSTANCES.

This act imposes an excise tax on the illegal possession of controlled substances, effective January 1, 1990. The act is designed to provide additional deterrence and punishment for illegal drug dealers as well as an economic disincentive to trafficking in drugs. The tax applies to possession of more than 42.5 grams of marijuana, seven or more grams of any other controlled substance sold by weight, or ten or more dosage units of a controlled substance not sold by weight. The tax is at the rate of $3.50 per gram of marijuana, $200 per gram of other controlled substance sold by weight, and $400 per ten dosage units of a controlled substance not sold by weight.

Like the cigarette tax, this tax is paid through the purchase of tax stamps. The stamps must be affixed to the substance to show that the tax has been paid. Failure to pay the tax is a felony; a person who possesses a controlled substance on which the tax is not paid is liable for the amount of the tax plus an additional penalty of 100% of the amount of tax due. Failure to pay the tax is a Class I felony, punishable by up to five years' imprisonment, an unlimited fine, or both.

This act requires local law enforcement agencies and the State Bureau of Investigation to notify the Department of Revenue of drug arrests to enable the Department to collect the

tax from those arrested. Because of uncertainty regarding the amount of revenue that may be derived from this tax, any proceeds collected are to be held in a special fund until the General Assembly determines that they may be deposited in the General Fund.

1989 Chapter 782 (House Bill 1668, Rep. R. Hunter)

AN ACT TO ALLOW AN ADDITIONAL THIRTY-DAY PERIOD FOR THE SELLER OF A MOTOR VEHICLE TO FILE AN AFFIDAVIT STATING THAT THE SALE WAS EXEMPT FROM SALES TAX AND TO CLARIFY THE LAW ABOLISHING PARENT-CHILD IMMUNITY IN MOTOR VEHICLE CASES.

This act gives a retailer who sells a motor vehicle to a nonresident a second chance to report the sale to the Department of Revenue, thereby preserving the conditional exemption of the sale of the motor vehicle from sales tax. Under prior law, G.S. 105-164.13(32) exempted from sales tax motor vehicles sold to nonresidents for immediate transportation to another state. To obtain the exemption, however, a retailer who sold a motor vehicle to a nonresident had to report the sale by affidavit to the Department of Revenue when filing the monthly sales tax return for the month in which the sale occurred. If the report was not filed with the proper monthly return, the exemption did not apply and the retailer was liable for the sales tax.

This act changes the conditional exemption in G.S. 105-164.13(32) to allow a retailer who did not report the sale of a motor vehicle to a nonresident with the proper monthly sales tax return to report the sale within 30 days after the Department of Revenue discovers the omission and still obtain the sales tax exemption for the vehicle. Although a motor vehicle reported within this "second-chance" period is exempt from sales tax, the retailer or the purchaser must pay a penalty of 25% of the amount of sales tax that would otherwise be due.

The act is effective August 12, 1989, and applies to discoveries of omitted reports made on or after that date. It does not apply to assessments of tax made before that date or to taxes already paid.

Because Chapter 692 of the 1989 Session Laws, discussed above, repeals the sales tax on motor vehicles effective October 1, 1989, the problem of omitted reports will eventually disappear. It will continue for a few years beyond the repeal of the tax, however, because it may be two years after a sale to a nonresident occurs before the Department audits the retailer who made the sale and discovers the retailer's failure to submit the report.

1989 Chapter 788 (Senate Bill 1336, Senator Bill Barker)

AN ACT TO INCREASE THE PERCENTAGE OF GAS TAX PROCEEDS TRANSFERRED EACH YEAR TO THE WILDLIFE RESOURCES COMMISSION.

This act increases the percentage of the net proceeds of the per gallon excise tax on gasoline that is transferred annually from the Highway Fund to the Wildlife Resources Commission from 1/8 of 1% of the net proceeds to 1/6 of 1% of the net proceeds. "Net proceeds" means the amount collected less the amount refunded. The act is effective for taxes levied on or after July 1, 1990.

The amount due the Wildlife Resources Commission is transferred to the Commission in January of each year. The transfer made in January of 1991 will therefore include transfers at both the 1/8 of 1% and 1/6 of 1% rates.

This act is a response to the separation of gasoline tax revenue into the Highway Fund and the Highway Trust Fund made by Chapter 692 of the 1989 Session Laws. Chapter 692 increases the gas tax by 25%, requires the 25% increase to be deposited in the Trust Fund, and requires the remaining 75% to be deposited in the Highway Fund. It also specifies that the transfer to the Wildlife Resources Commission is to be based on only the amount of gas tax proceeds deposited in the Highway Fund and not the Highway Trust Fund. This act compensates for the denial of a percentage of the Trust Fund by increasing the percentage the Wildlife Resources Commission receives from the Highway Fund.

1989 Chapter 792 (House Bill 1311, Rep. Alex Hall)

AN ACT TO PROVIDE INCOME TAX EXEMPTIONS FOR ALL RETIREES AND TO INCREASE STATE AND LOCAL RETIREMENT BENEFITS.

The United States Supreme Court decided the case of Michigan v. Davis, 109 Sup. Ct. 1500 (1989), on March 28, 1989. In that case, a retired federal employee challenged the Michigan tax system which exempted from taxation the retirement benefits of retired state and local employees but fully taxed all other retirement benefits. The Court held that Michigan's tax law violated the constitutional doctrine of intergovernmental tax immunity, which prohibits taxes imposed directly on one sovereign by another and taxes that discriminate against one sovereign or those with whom it deals. Pursuant to this doctrine, the Court held that the state must treat federal employees and state employees equally for tax purposes.

The Michigan v. Davis case implicated the North Carolina income tax system, which provided full tax exemptions to retirement benefits of State and local government retirees but only partial exclusions for federal retirees. In order to bring the tax law in compliance with the new rule, this act allows an equal tax exclusion of $4,000 for all public retirees---state, local, and federal. To help offset the impact of the tax on state and local retirees who formerly paid no State income tax on their retirement benefits, the act provides for an increase in the amount of retirement benefits paid to these retirees.

In addition, in order to partially equalize the treatment of private retirees (who previously received no tax exclusion) and public retirees, the act allows a $2,000 tax exclusion for private retirement benefits.

In the case of a married couple filing a joint return, the maximum amounts of the exclusions provided by this act apply separately to each spouse if both receive retirement benefits. The $4,000 exclusion for public retirement benefits and the $2,000 exclusion for private retirement benefits are not cumulative, however. A person who receives both public and private retirement benefits is entitled to a maximum exclusion of $4,000. The act is effective for taxable years beginning on or after January 1, 1989.

1988

1988 Chapter 882 (House Bill 2227, Rep. Bob Etheridge)

AN ACT TO AUTHORIZE THE CREATION OF NORTH CAROLINA ENTERPRISE CORPORATIONS.

Effective for taxable years beginning on or after January 1, 1988, this act provides income and franchise tax credits for 25% of the amount of an investment in a "North Carolina Enterprise Corporation." The credits are similar to those currently allowed under Division V of Article 4 of Chapter 105 of the General Statutes for investments in North Carolina Capital Resource Corporations, qualified investment organizations, qualified business ventures, and qualified grantee businesses. A $12 million-dollar annual limit applies to the total amount of credits the State will allow. The act adds a new Article 3A to Chapter 53A of the General Statutes authorizing the creation of enterprise corporations which will provide capital to qualified North Carolina businesses in rural areas in order to enhance economic development. The enterprise corporation concept was developed by the Rural Economic Development Center.

1988 Chapter 892 (House Bill 142, Rep. Jeralds)

AN ACT TO INCREASE THE ANNUAL INCOME TAX EXCLUSION FOR FEDERAL CIVIL SERVICE AND MILITARY RETIREMENT PAY.

Effective for taxable years beginning on or after January 1, 1989, this act increases the individual income tax exclusions for federal civil service retirement pay and military retirement pay from $3,000 to $4,000.

1988 Chapter 936 (House Bill 2170, Rep. Lilley)

AN ACT TO EXPAND THE INCOME TAX EXEMPTION FOR DOUBLE LEG AMPUTEES TO INCLUDE BELOW-THE-KNEE AMPUTATION.

Prior law allowed a $1,100 individual income tax exemption for individuals who have both legs amputated above the knee. Effective for taxable years beginning on or after January 1, 1988, this act extends the exemption to all double leg amputations **above the ankle.** Recommended by Revenue Laws Study Committee.

1988 Chapter 937 (House Bill 2186, Rep. Lilley)

AN ACT TO EXEMPT INSULIN FROM SALES AND USE TAXES.

Prior law provided a sales and use tax exemption for medicines sold on prescription. Federal law does not require a prescription for the sale of insulin. Effective for sales made on or after August 1, 1988, this act provides that sales of insulin shall be exempt from sales and use taxes. Recommended by Revenue Laws Study Committee.

1988 Chapter 941 (Senate Bill 1601, Senator Rauch)

AN ACT TO LIMIT THE INCOME TAX DEPENDENCY EXEMPTION TO RELATIVES AND FOSTER CHILDREN OF THE TAXPAYER AND DEPENDENTS OF WHOM THE TAXPAYER HAS LEGAL CUSTODY.

Prior law allowed a taxpayer to claim an $800 income tax exemption for dependents who are members of the same household, but not for the taxpayer's spouse. The effect of the law was to give a tax break to unmarried couples who live together but not to married couples. Effective for taxable years beginning on or after January 1, 1988, this act makes the dependency exemption unavailable to unmarried couples by requiring that the dependent be related to the taxpayer by blood, adoption, or affinity. (The dependency exemption will remain unavailable for spouses).

1988 Chapter 994 (House Bill 2372, Rep. Miller)

AN ACT TO AMEND THE FORMULA USED TO APPORTION THE INCOME OF MULTI-STATE CORPORATIONS TO THIS STATE FOR INCOME TAXATION AND TO CONFORM THE FORMULA FOR PAYMENT OF ESTIMATED TAXES TO THE FEDERAL FORMULA.

G.S. 105-130.4(i) provides that the income of a multi-state corporation shall be apportioned to this State using a three-factor formula based on the corporation's payroll located in this State, the corporation's property located in this State, and the corporation's sales in this State. Current law weights each of these factors equally. Effective for taxable years beginning on or after January 1, 1989, Section 1 of this act provides that the sales factor will be given double weight. This will affect the amount of corporate franchise tax due as well as the amount of income that is apportioned to this State.

Effective for taxable years beginning on or after June 25, 1988, Sections 2 and 3 of the act modify the rules for payment of estimated corporate income taxes to conform them to the federal rules. These conforming changes increase the amount of the payments due from 80% to 90% of the estimated tax liability for the current year and provide that large corporations (corporations having taxable income of $1,000,000 or more) may not take advantage of a provision in current law that decreases the amount due if the previous year's tax liability was less than 90% of the current year's liability.

1988 Chapter 1001 (House Bill 2169, Rep. Lilley)

AN ACT TO CHANGE THE EFFECTIVE DATE OF THE TRANSFER OF RESPONSIBILITY FOR ISSUING BINGO LICENSES FROM THE DEPARTMENT OF REVENUE TO THE DEPARTMENT OF HUMAN RESOURCES.

Chapter 866 of the 1987 Session Laws transferred the responsibility for issuing bingo license and establishing audit procedures for bingo accounts from the Department of Revenue to the Department of Human Resources. The act never became effective because it was conditioned on an appropriation that was never made. This act makes the transfer effective September 1, 1988. Recommended by Revenue Laws Study Committee.

1988 Chapter 1013 (House Bill 2376, Rep. Redwine)

AN ACT TO PROVIDE AN ADDITIONAL ONE THOUSAND ONE HUNDRED DOLLARS ($1,100) INCOME TAX EXEMPTION FOR TAXPAYERS AND THEIR DEPENDENTS WHO HAVE MUSCULAR DYSTROPHY.

Effective for taxable years beginning on or after January 1, 1988, this act adds an additional $1,100 individual income tax exemption for taxpayers and their dependents who have muscular dystrophy. To claim the exemption, the taxpayer must attach to the tax return a doctor's certification.

1988 Chapter 1015 (Senate Bill 1612, Senator Guy)

AN ACT TO UPDATE THE REFERENCE TO THE INTERNAL REVENUE CODE USED TO DETERMINE CERTAIN TAXABLE INCOME AND TAX EXEMPTIONS.

This bill rewrites the definition of the Internal Revenue Code used in State tax statutes to change the reference date from January 1, 1987, to January 1, 1988. Updating the reference makes recent amendments to the Internal Revenue Code applicable to the State to the extent State tax law previously tracked federal law. This update has the greatest effect on State corporate income taxes because these taxes are a percentage of federal taxable income and are therefore closely tied to federal law. Individual income taxes are not tied to federal law in the same way, but many individual income tax deductions are based on federal tax deductions. Recommended by Revenue Laws Study Committee.

1988 Chapter 1032 (House Bill 2429, Rep. Stamey)

AN ACT TO PROVIDE AN ADDITIONAL ONE THOUSAND ONE HUNDRED DOLLARS INCOME TAX EXEMPTION FOR TAXPAYERS AND THEIR DEPENDENTS WITH TRANSPLANTED ORGANS OR TISSUES.

Effective for taxable years beginning on or after January 1, 1988, this act adds an additional $1,100 individual income tax exemption for taxpayers and their dependents who have received organ or tissue transplants and are required to take immunosuppressant medications. To claim the exemption, the taxpayer must attach to the tax return a doctor's certification.

1988 Chapter 1039 (House Bill 2648, Rep. Miller)

AN ACT TO CLOSE LOOPHOLES THAT ALLOW HIGH-INCOME TAXPAYERS TO CLAIM THE LOW-INCOME TAX CREDIT AND TO INCREASE THE MAXIMUM FEES THAT CAN BE ESTABLISHED BY THE MANUFACTURED HOUSING BOARD AND THE BOARD OF PHARMACY.

G.S. 105-151.16 provides an individual income tax credit for taxpayers with net taxable income of $15,000 or less. Effective for taxable years beginning on or after January 1, 1988, Section 1 of this act revises G.S. 105-151.16 to provide that a married couple's income will be combined to determine eligibility for the credit, and to provide that individuals and married couples who have gross income of $30,000 or more are not eligible for the credit. Sections 2 and 3 of this act make changes regarding fees that can be established by certain occupational licensing boards.

1988 Chapter 1041 (Senate Bill 1645, Sen. Winner)

AN ACT TO MODIFY THE FORMULA FOR REIMBURSING LOCAL GOVERNMENTS FOR REVENUE LOST DUE TO THE REPEAL OF PROPERTY TAXES ON INVENTORIES AND TO MAKE TECHNICAL CHANGES.

This act exempts from property taxes livestock and poultry that is not already exempt as inventory and modifies the reimbursement statutes enacted by the School Facilities Finance Act of 1987 to reimburse local governments for their losses due to the repeal of the property tax on inventories. It provides a method for counties and cities to share reimbursement funds with their special districts, replaces the "county area hold harmless" formula with an "individual county and city hold harmless" formula to eliminate losses that would have occurred under the prior law, provides for correction of errors in calculating the reimbursements, provides that reimbursements will be made for poultry and livestock beginning in 1990, and makes a technical change regarding the source of the funds to pay for the reimbursements provided.

Section 1 of this act rewrites parts of G.S. 105-275.1, the manufacturers' inventory reimbursement statute. The changes in the first part of subsection (a) provide that livestock and poultry and other similar products will be counted in calculating the amount of the inventory tax loss; reimbursement for these items will be made beginning in 1990. The changes at the end of subsection (a) and in subsection (b) provide a method for counties and cities to share funds received with their special districts: each county and city will calculate the inventory tax loss for each district and divide the funds attributable to special districts among them in proportion to their losses. The Local Government Commission is authorized to adopt rules to resolve any disputes that may arise, to correct any errors, and to provide for cases where a special district is dissolved or merged. The Local Government Commission is also directed to report to the 1990 General Assembly any inaccuracies it discovers in the information furnished by local governments to the Department of Revenue regarding the amount of their losses. Section 1 also adds a new subsection (f) at the end of G.S. 105-275.1. This new subsection provides that if the Secretary of Revenue discovers any errors in the amount or value of inventories or other items listed by a city or county, she may adjust the amount of the reimbursement to correct the error.

Sections 1.1, 1.2, and 1.3 provide that poultry and livestock and feed used in their production, if not already exempt as inventory, shall be exempt from property taxes effective for taxable years beginning on or after January 1, 1989.

Section 2 of the act rewrites G.S. 105-277A, the wholesalers' and retailers' inventory reimbursement statute. The changes convert the formula for the 80% exemption enacted in 1987 from a two-step process that first made a per capita calculation and then a county-area hold harmless calculation to a new formula. Under the new formula, each county will receive a per capita distribution that will be shared with the cities on an ad valorem basis. Then, the Secretary will calculate whether any city or county suffered a loss under this formula. If so, it will receive additional funds to make sure the amount of the reimbursement was sufficient to cover its losses due to the inventory tax repeal. Further, if the amount of the county or city's loss calculated by the Secretary (based on an average of inventory taxes over the last eight years) is below 90% of the actual inventory levy for 1987, the Secretary will distribute to the county or city an additional amount to bring its reimbursement up to 90% of its 1987 inventory levy.

This statute is also amended to provide for distribution to special districts in the same manner as under the manufacturers' inventory reimbursement discussed above, and to provide that the Secretary may correct any errors in the amount or value of inventories listed by a

county or city. Finally, the statute is amended to change the source of the funds for the reimbursements from income tax collections to sales tax collections. Most of the provisions of this act were recommended by the Revenue Laws Study Committee.

1988 Chapter 1044 (House Bill 2171, Rep. Lilley)

AN ACT TO MAKE TECHNICAL AMENDMENTS TO THE REVENUE LAWS.

Sections 1 through 12 of this act correct typographical errors, update obsolete references, make conforming changes, and clarify various provisions of the Revenue Act. Section 13 adds a notice requirement that was inadvertently deleted from the Machinery Act in 1987. Sections 13.1 and 13.2 provide that land enrolled in the federal Conservation Reserve Program shall not be disqualified from present use value treatment on the grounds that it is not in actual production. If the land is disqualified based on a change in income due to placement in the program, no deferred taxes shall be owed. Section 13.3 provides that the Committee to Elect Julian Pierce, Superior Court Judge may expend its funds for charitable purposes. Sections 1-13 of this act were recommended by the Revenue Laws Study Committee.

1988 Chapter 1047 (House Bill 2390, Rep. Fussell)

AN ACT TO PROVIDE THAT THE INVENTORY TAX REIMBURSEMENT CALCULATION FOR WAKE FOREST SHALL INCLUDE THE VALUE OF MANUFACTURERS' INVENTORIES LOCATED IN AN AREA THAT WAS THE SUBJECT OF LITIGATION CHALLENGING ITS ANNEXATION AT THE TIME THE TAX ON INVENTORIES WAS REPEALED.

This act provides that when the Secretary of Revenue makes reimbursements to local governments to compensate for their revenue losses due to repeal of the property tax on manufacturers' inventories, she shall calculate the amount to be reimbursed to the City of Wake Forest based on inventories that were located in an area that the city was seeking to annex, in addition to other inventories located in the city.

1988 Chapter 1052 (House Bill 2651, Rep. Watkins)

AN ACT TO CORRECT THE DATES FOR PHASE-IN OF THE MODIFIED SYSTEM FOR ADJUSTING THE ASSESSMENT LEVEL OF PUBLIC SERVICE COMPANY SYSTEM PROPERTY.

Effective January 1, 1988, this act provides that where, due to problems with the dates for phasing in new legislation regarding adjustment of the assessment level of public service company property, the assessment level of a public service company's property is reduced in a county in the third year following the last general reappraisal of real property and again in the fourth year following reappraisal, then in the fourth year the amount of the third year reduction shall be added back into the fourth year assessment level. This will eliminate the windfall that would have accrued to public service companies from reductions in both the third and fourth years.

1988 Chapter 1063 (House Bill 1124, Rep. Jones)

AN ACT TO LIMIT CAMPAIGN EXPENDITURES AND TO STRENGTHEN PUBLIC FINANCING OF POLITICAL CAMPAIGNS.

This act establishes the North Carolina Candidates Financing Fund. Effective for taxable years beginning on or after January 1, 1988, Section 2 of this act amends G.S. 105-163.16 to provide that any taxpayer entitled to an income tax refund may contribute all or part of the refund to the North Carolina Candidates Financing Fund. Space and instructions will be provided on the income tax forms.

1988 Chapter 1076 (House Bill 1144, Rep. Miller)

AN ACT TO AMEND THE LAW RELATING TO PENALTIES FOR VIOLATION OF THE REVENUE LAWS.

Effective October 1, 1988, this act makes the following changes to the penalties for violation of the Revenue Act:

1. Increases the penalty for attempting to evade or defeat a tax from a misdemeanor with a maximum fine of $1,000 and maximum imprisonment of 6 months to a misdemeanor with no specified punishment. (G.S. 14-3 provides that where no punishment is specified for a misdemeanor, it is punishable by up to 2 years in prison and/or a fine in any amount, and where it is an "infamous" misdemeanor, i.e., done in secrecy and malice, or with deceit and intent to defraud, it is punishable by up to 10 years in prison and/or a fine in any amount).
2. Increases the penalty for willful failure to collect, withhold, or pay over a tax from a misdemeanor with a maximum fine of $500 and maximum imprisonment of 6 months to a misdemeanor with a maximum fine of $1,000 and maximum imprisonment of 2 years.
3. Makes it unlawful to willfully aid and abet the filing of a false or fraudulent document; a violation is punishable as a misdemeanor with no specified fine or maximum term of imprisonment. (See #1 above).
4. Increases the penalty for willful failure to file return, supply information, or pay tax from a misdemeanor with a maximum fine of $200 and maximum imprisonment of 30 days to a misdemeanor with no specified punishment. (See #1 above).

1988 Chapter 1081 (House Bill 1206, Rep. Miller)

AN ACT TO REPEAL AN OBSOLETE PROVISION IN THE REVENUE LAWS, MODIFY THE DEFINITION OF "FLEA MARKET" FOR LICENSE TAX PURPOSES, AND MAKE TECHNICAL CORRECTIONS TO ELECTION LAWS, AND THE EMPLOYEE THEFT STATUTE.

Effective July 1, 1988, this act repeals the $500 license tax for mercantile agencies. Also effective July 1, 1988, the act revises the definition of "flea market" for license tax purposes to exclude locations within the enclosed area of a mall or shopping center. This act also contains provisions relating to election laws and employee theft that do not affect tax law.

1988 Chapter 1082 (House Bill 1288, Rep. Miller)

AN ACT TO REPEAL AN OBSOLETE LAW, TO MAKE TECHNICAL CHANGES TO THE REVENUE ACT, TO MODIFY THE LAW REGARDING PRIVILEGE LICENSES FOR CERTAIN EMPLOYMENT AGENCIES, TO MODIFY THE STANDARDS FOR ISSUING LICENSES FOR REFRIGERATION CONTRACTORS, AND TO MAKE CLARIFYING AND TECHNICAL AMENDMENTS TO VARIOUS LAWS RELATING TO LOW-LEVEL RADIOACTIVE WASTE AND HAZARDOUS WASTE.

Effective July 1, 1988, Sections 1 and 1.1 of this act repeal the privilege license tax on carnival companies. Sections 2, 3, and 4 make a technical change to the law regarding adjustment of the amounts of local sales and use taxes to be distributed to local governments. Section 5 relates to the standards for licensing refrigeration contractors. Section 6 removes the requirement that, in order to receive a special privilege license, an employment agency for school employees be approved by the State Superintendent of Public Instruction. Sections 7, 8, and 8.1 make changes regarding tinted windows on motor vehicles. The rest of the act makes clarifying and technical changes to laws relating to low-level radioactive and hazardous waste.

1988 Chapter 1089 (House Bill 2389, Rep. Hall)

AN ACT TO PROVIDE FOR SPECIAL TAX TREATMENT OF SUBCHAPTER S CORPORATIONS.

Effective for taxable years beginning on or after July 1, 1990, this act provides that corporations that have Subchapter S status for federal income tax purposes shall receive the same treatment for State income tax purposes. An individual who is a shareholder in a Subchapter S corporation will pay individual income tax on his or her pro rata share of the corporation's net income, rather than having the income taxed at the corporate level. The act, based on uniform legislation developed by the American Bar Association, sets out procedures for apportioning to this State the income of multi-state Subchapter S corporations and provides transitional rules.

1988 Chapter 1096 (House Bill 2430, Rep. Miller)

AN ACT TO PROVIDE THAT SALES AND USE TAXES SHALL BE IMPOSED ON CERTAIN MAIL ORDER SALES.

Effective for sales made on or after January 1, 1989, this act expands the Sales and Use Tax Act to allow the State to require out-of-State retailers to collect sales and use taxes on mail order sales to North Carolina customers if the retailer has purposefully or systematically exploited the market in this State through solicitation by mail or by advertising in print or electronic media.

In 1967, the United States Supreme Court decided the case of National Bellas Hess, Inc. v. Illinois, 386 U.S. 753 (1967). In that case, the court held that a State may not require a retailer to collect sales and use taxes from customers in the State if the retailer's only connection with customers in the State is by common carrier or United States mail. Such state action would invade the exclusive authority of Congress to regulate interstate commerce and would violate the due process requirement that there be some nexus between a State and the person it seeks to tax.

North Carolina currently requires a retailer to collect sales and use taxes if the retailer (i) has, directly or through an agent, any office, place of distribution, or other place of business in the State, (ii) has, permanently or temporarily, any person operating in the State in soliciting, selling, or delivering, or (iii) maintains in the State, permanently or temporarily, any tangible

personal property for lease or rental. This act expands the law to require a retailer to collect the taxes from its North Carolina customers if the retailer creates nexus with this State "by purposefully or systematically exploiting the market provided by this State by any media-assisted, media-facilitated, or media-solicited means, including direct mail advertising, distribution of catalogues, computer-assisted shopping, television, radio or other electronic media, or magazine or newspaper advertisements, or other media."

While this expansion appears to violate the rule stated in the 1967 Bellas Hess case, it is consistent with an interpretation, developed by the Multistate Tax Commission, that contends that the decision was based on interstate commerce clause considerations rather than Due Process, and that therefore only "minimum contacts" by the retailer are necessary to justify the State's tax jurisdiction. A number of other states have extended their sales tax laws accordingly; North Dakota has recently filed a test case seeking to require Speigel to collect the tax.

The act recognizes that federal legislation is pending to directly authorize states to require out-of-state mail order companies to collect sales taxes. If such legislation passes, and if it applies only to States that have a uniform tax rate statewide, the act provides that counties may not repeal their local sales and use taxes in effect at the time.

The act also authorizes the Secretary of Revenue to work with other states to enhance collection of sales taxes on mail order sales, and requires the Department of Revenue to study the consequences of the act and report any findings and recommendations to the Revenue Laws Study Commission or to the General Assembly.

1987

1987 Chapter 832 (Senate Bill 944, Sen. Goldston.)

AN ACT TO INCREASE THE EXCISE TAX ON SPIRITUOUS LIQUOR AND TO PROVIDE THAT LOCAL SALES TAXES SHALL BE LEVIED BY THE COUNTY IN WHICH THE RETAILER IS LOCATED WHEN THE PROPERTY SOLD IS DELIVERED TO THE PURCHASER IN ANOTHER COUNTY

This act increased the excise tax on spirituous liquor from 22.5% to 28%, effective October 1, 1987.

This act also closed a loophole with respect to local sales and use taxes. Under prior law, local option sales and use taxes did not apply to sales where the tangible personal property was sold in one county and delivered to the purchaser in another county. Instead, the purchaser was liable for use tax levied by the purchaser's county. In practice, this use tax was often not collected. Effective March 1, 1988, this act provided that the situs of a sale is considered to be the county of the retailer's place of business. Thus, if property is sold by a retailer in one county and delivered to a purchaser in another county, the local sales tax of the retailer's county applies to the sale.

This change in the situs, for local sales tax purposes, from the purchaser's county to the seller's county, would have resulted in some counties gaining revenue and others losing revenue. In order to hold counties harmless, this act amends the distribution formula for the two half-cent taxes, which are distributed on a per capita basis. Each county's allocation is adjusted up or down by a percentage before distribution. This adjustment offsets the fiscal impact of the change in tax situs, so that local governments are held harmless.

1987 Chapter 622 (House Bill 1155)

AN ACT TO CREATE THE PUBLIC SCHOOL BUILDING CAPITAL FUND TO ASSIST COUNTY GOVERNMENTS IN MEETING THEIR PUBLIC SCHOOL BUILDING CAPITAL NEEDS, TO CREATE THE CRITICAL SCHOOL FACILITY NEEDS FUND TO PROVIDE FUNDS FOR COUNTIES THAT HAVE THE GREATEST CRITICAL SCHOOL FACILITY NEEDS, TO CREATE A COMMISSION TO DETERMINE THE CRITICAL SCHOOL FACILITY NEEDS OF EACH COUNTY, TO REPEAL THE TAX ON INVENTORIES OF MANUFACTURERS, RETAILERS, AND WHOLESALERS, TO REIMBURSE LOCAL GOVERNMENTS FOR THE RESULTING REVENUE LOSS, TO INCREASE THE CORPORATE INCOME TAX, TO REQUIRE MOST EMPLOYERS TO REMIT WITHHOLDING TAXES ON A MONTHLY BASIS, TO REPEAL THE RETAILERS' DISCOUNT FOR PAYMENT OF SALES AND USE TAXES WHEN DUE, AND TO EARMARK ADDITIONAL LOCAL SALES AND USE TAX PROCEEDS FOR PUBLIC SCHOOL CONSTRUCTION.

In 1987, the General Assembly increased the corporate income tax from 6% to 7% and earmarked half of the increase for local school facility needs. This change was part of a package in which the property tax on manufacturing inventory was repealed and the remaining 80% of wholesale/retail inventories was exempted from property tax.