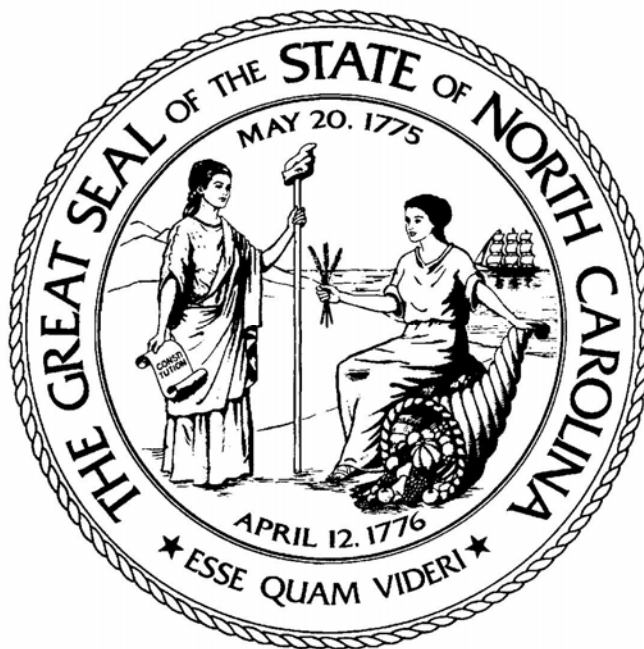


# REVENUE LAWS STUDY COMMITTEE



REPORT TO THE 2003  
GENERAL ASSEMBLY OF NORTH CAROLINA  
2003 SESSION

A LIMITED NUMBER OF COPIES OF THIS REPORT IS AVAILABLE  
FOR DISTRIBUTION THROUGH THE LEGISLATIVE LIBRARY

ROOMS 2126, 2226  
STATE LEGISLATIVE BUILDING  
RALEIGH, NORTH CAROLINA 27611  
TELEPHONE: (919) 733-7778

OR

ROOM 500  
LEGISLATIVE OFFICE BUILDING  
RALEIGH, NORTH CAROLINA 27603-5925  
TELEPHONE: (919) 733-9390

THE REPORT IS ALSO AVAILABLE ON-LINE:  
<http://www.ncleg.net/LegLibrary/>

# TABLE OF CONTENTS

Letter of Transmittal .....	i
Revenue Laws Study Committee Membership .....	ii
Preface.....	1
Committee Proceedings .....	3
Committee Recommendations and Legislative Proposals.....	15
1. AN ACT TO UPDATE THE REFERENCE TO THE INTERNAL REVENUE CODE USED IN DEFINING AND DETERMINING CERTAIN STATE TAX PROVISIONS .....	16
2. AN ACT TO ADJUST THE APPORTIONMENT FORMULA SALES FACTOR FOR BROADCASTERS AND PUBLISHERS AND TO UPDATE THE APPORTIONMENT FORMULA PROPERTY FACTOR FOR ALL CORPORATIONS BY EXCLUDING OUTER- JURISDICTIONAL PROPERTY FROM THAT FACTOR .....	24
3. AN ACT TO ADOPT THE STREAMLINED SALES TAX CHANGES.....	40
4. 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 .....	48
5. AN ACT TO ESTABLISH A UNIFORM PROCEDURE FOR TAX REFUND CLAIMS .....	59
6. AN ACT TO MODIFY THE DIVIDENDS 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, AND TO MAKE VARIOUS	

ADMINISTRATIVE CHANGES IN THE TAX LAWS .....	72
7. AN ACT TO MAKE TECHNICAL AND CLARIFYING CHANGES TO THE REVENUE LAWS AND RELATED STATUTES .....	86

## Appendices

- A. Authorizing Legislation, Article 12L of Chapter 120 of the General Statutes
- B. Disposition of Committee's Recommendations to the 2002 Session
- C. Department of Revenue Report on the Collection of Tax Debt
- D. State Budget Outlook: More of the Same?
- E. Memo from the Department of Revenue to the Revenue Laws Study Commission on the Tax Credit for Premiums paid on Long-Term Care Insurance
- F. History of Dividend Deduction
- G. History of Bank Expense Deduction
- H. Fiscal Report on Dividend Issue
- I. Department of Revenue Report on Effect of Tax Law Changes
- J. Memo from Martha Walston to the Revenue Laws Study Committee re: North Carolina's Allocation and Apportionment of Income for Corporations
- K. A copy of the Multistate Tax Commission's Regulations re: Apportionment of Income for Broadcasting and Publishing Companies
- L. A list of the States that have Adopted the MTC Model Regulations in Whole or in Part.
- M. Department of Revenue's Recommended Changes to North Carolina's Apportionment Laws
- N. Revenue Changes under Special Apportionment Rules for Publishing and Broadcasting Firms, prepared by the Tax Research Division of the Department of Revenue



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

*Senator John H. Kerr, III, Co-Chair*

*Representative Paul Luebke, Co-Chair*

**January 28, 2003**

**TO THE MEMBERS OF THE 2003 GENERAL ASSEMBLY (2003 Regular Session):**

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

Respectfully Submitted,

---

Rep. Paul Luebke, Co-Chair

---

Sen. John Kerr, Co-Chair

2001-2002

REVENUE LAWS STUDY COMMITTEE

MEMBERSHIP

Senator John H. Kerr, III  
Cochair

Representative Paul Luebke  
Cochair

Senator Daniel Clodfelter  
Senator Walter H. Dalton  
Senator Fletcher L. Hartsell, Jr.  
Senator David W. Hoyle  
Mr. Leonard Jones  
Mr. J. Micah Pate, III  
Senator Hugh Webster

Rep. Gordon Allen  
Rep. Monroe Buchanan  
Rep. Dewey L. Hill  
Rep. Hugh Holliman  
Rep. Mary Jarrell  
Rep. Daniel McComas  
Rep. William Wainwright

Staff:

Blinda Edwards, Committee Clerk

Cindy Avrette, Legislative Analyst  
Richard Bostic, Fiscal Analyst  
David Crotts, Fiscal Analyst  
Trina Griffin, Legislative Analyst  
Martha H. Harris, Legislative Analyst  
Canaan Huie, Legislative Analyst  
Linda Millsaps, Fiscal Analyst  
Mary Shuping, Legislative Analyst  
Martha Walston, Legislative Analyst

## PREFACE

---

The Revenue Laws Study Committee is established in Article 12L of Chapter 120 of the General Statutes to serve as a permanent legislative commission to review issues relating to taxation and finance. The Committee consists of sixteen members, eight appointed by the President Pro Tempore of the Senate and eight appointed by the Speaker of the House of Representatives. Committee members may be legislators or citizens. Each of the appointing authorities designates one member to serve as co-chair. The co-chairs for 2001-2002 are Senator John Kerr and Representative Paul Luebke.

G.S. 120-70.106 gives the Revenue Law Study Committee's study of the revenue laws a very broad scope, stating that the Committee "may review the State's revenue laws to determine which laws need clarification, technical amendment, repeal, or other change to make the laws concise, intelligible, easy to administer, and equitable." A copy of Article 12L of Chapter 120 of the General Statutes is included in Appendix A. A committee notebook containing the committee minutes and all information presented to the committee is filed in the Legislative Library.

In 2002, the General Assembly established a permanent subcommittee under the Revenue Laws Study Committee to study and examine the property tax system.<sup>1</sup> The subcommittee consists of six members, three appointed by the Senate chair of the Revenue Laws Study Committee and three appointed by the House chair of the Committee. The subcommittee may recommend changes in the property tax system to the full Committee for its consideration in its final report to the General Assembly. The chairs to the Revenue Laws Study Committee did not appoint the subcommittee during this interim because of the limited time the Committee had to meet

---

<sup>1</sup> S.L. 2002-184, s. 8.

before the convening of the 2003 Regular Session of the 2003 General Assembly.

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



## COMMITTEE PROCEEDINGS

---

The Revenue Laws Study Committee met three times after the 2002 Regular Session of the 2001 General Assembly adjourned on October 4, 2002. Although the Committee received many requests from legislators, taxpayers, the Department of Revenue, and interest groups to study numerous issues of tax policy and tax administration, the Committee was not able to consider all of them in the limited time available to it. The Committee considered all proposed tax changes in light of general principles of tax policy and as part of an examination of the existing tax structure as a whole.

### REVIEW OF THE RECOMMENDATIONS MADE TO THE 2002 GENERAL ASSEMBLY

The 2002 General Assembly enacted seven of the Revenue Laws Study Committee's eight legislative proposals in whole or in part.<sup>1</sup> Appendix B lists the Committee's recommendations and the action taken on them in 2001. A document entitled "**2002 Tax Law Changes**" summarizes all of the tax legislation enacted in 2002. It is available in the Legislative Library located in the Legislative Office Building.

### BUDGET AND REVENUE OUTLOOK

The General Assembly gave the Department of Revenue additional collection tools during the 2001 Session with the expectation that the Department would collect \$150 million in back taxes by June 30, 2003. The program for collecting outstanding back taxes became known as "Project Collect Tax". Secretary Tolson informed the Committee that the Department expected to exceed its goal by the end of the 2002-2003 fiscal year. From

---

<sup>1</sup> The eighth proposal, Disclose Social Security Number to Tax Collector, was not introduced as a piece of legislation for the General Assembly to consider during the 2002 Regular Session.

August 2001 until November 2002, the Department has collected \$110 million in back taxes. A copy of the Department's report on the collection of tax debt<sup>2</sup> is included as Appendix C. One of the additional collection tools given to the Department was the authorization to use collection agencies to collect in-State tax debts for two years. This authorization expires July 1, 2003. Legislative Proposal 6, *Revenue Administrative Changes*, contains a provision extending this authorization for an additional two years.

David Crotts, with the Fiscal Research Division, reviewed the State's budget outlook with the Committee. The fiscal analysts estimate that the 2003-04 fiscal year budget gap will be around \$2 billion. Little, if any, revenue surplus for the current fiscal year, coupled with subpar revenue growth expected in 2003-04 and the use of one-time revenue sources over the last two years, contributes to the expected budget shortfall. Over the past two years, the General Assembly has enacted several revenue enhancements. The most obvious revenue enhancements available to the General Assembly in 2003 include the continuation of the ½ cent State sales tax that is scheduled to expire on July 1, 2003, the continuation of the 8.25% income tax bracket that is set to expire for taxable years beginning on or after January 1, 2004, and the delay of the 2001 tax cuts for an additional year. Even with these revenue enhancements, the State budget gap exceeds \$1.5 billion. Appendix D contains a discussion of the State's budget outlook.

The Honorable Thomas Ross, the chair of the Governor's Commission to Modernize State Finances, presented the Commission's Final Report to the Revenue Laws Study Committee.<sup>3</sup> The Governor created the Commission out of recognition that the State's fiscal system faces long-term challenges. He charged the Commission with the task of modernizing State finances to ensure that the State's revenue system remains stable, fair, and sufficient over the long term. The Commission's recommendations include the following:

- Eliminate the differential rates of taxation of goods and services and remove caps on the sales and use taxes.

---

<sup>2</sup> G.S. 105-243.1(f) requires the Department of Revenue to report its progress regarding the collection of tax debt to the General Assembly.

<sup>3</sup> The Commission's Final Report is available on line at <http://www.osbm.state.nc.us>

- Eliminate sales tax exemptions.
- Consider the expansion of the sales tax base to include more services.
- Adopt changes required to comply with the Streamlined Sales Tax Agreement.
- Simplify the administration of local sales taxes.
- Tie State income tax more closely to the federal tax code.
- Adopt strategies to help low-income taxpayers.
- Eliminate or simplify the use of tax credits.
- Simplify taxation by moving to combined reporting by related entities.
- Modernize the franchise tax.
- Consider the effect of establishing a throw-out provision.
- Conform more closely to the federal definition of corporate income.
- Consider the effects of a move back to the equal weighting of payroll, property, and sales in determining the share of income taxed by the State for multistate corporations.
- Shift Medicaid program costs from counties to State government.
- Establish a new State-Local Relations Commission.
- Review the State unemployment insurance tax laws.

### **INCOME TAX**

The Revenue Laws Study Committee spent considerable time reviewing several different individual and corporate income tax provisions.

The General Assembly enacted the individual income tax credit for premiums paid on long-term care insurance in 1998. The credit amount is equal to 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 became effective for taxable years beginning on or after January 1, 1999. It expires for taxable years beginning on or after January 1, 2004, unless the 2003 General Assembly enacts legislation to extend or repeal the sunset on the credit. The Department of Revenue reported that in examining a sample of returns, it found that 90% of the taxpayers claiming the credit were not in fact eligible for the credit. Appendix E contains a copy of the Department's findings. The Committee did not make any recommendations on this issue.

North Carolina's tax law tracks many provisions of the federal

Internal Revenue Code by reference to the Code.<sup>4</sup> The General Assembly determines each year whether to update its reference to the Internal Revenue Code.<sup>5</sup> 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. Legislative Proposal 1, *IRC Update*, changes the statutory reference to the Code from May 1, 2002, to January 1, 2003. Congress enacted one bill between May 1, 2002, and January 1, 2003, that would affect State tax provisions. The Clergy Housing Allowance Clarification Act of 2002, P.L. 107-181, enacted on May 20, 2002, 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.

The issues of the dividend deduction and the banks' expense deduction have long been debated by the North Carolina General Assembly. During the 2001 Session, the 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. As a result, expenses related to deductible dividends must be netted from those dividends. During the 2002 Session, the General Assembly changed the expense-netting requirement, as it pertains to subsidiary dividends, by establishing guidelines on how to determine the amount of expenses attributable to dividends and by limiting how much of those attributable expenses must be netted. The 2002 legislation directed the Revenue Laws Study Committee to study the

---

<sup>4</sup> 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.

<sup>5</sup> 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."

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's staff presented information on the history of the dividend deduction and the bank expense deduction. A copy of the information the Committee received can be found in Appendices F – H.

In 2001, the General Assembly enacted three separate and distinct corporate income tax changes:

- Income Tax Reporting Option for Royalty Income
- Franchise Tax on Corporate Members of LLCs
- Income Tax of Dividends

The legislation directed the Department of Revenue to report to the Revenue Laws Study Committee on the implementation of these tax law changes and to recommend any changes it thought necessary to the Committee.<sup>6</sup> The Department's third and final report is attached in Appendix I.

The Department raised two issues concerning income derived from intangible property. The Department has seen several cases in which an operating company transferred patents to a holding company that then licensed the patents back to the operating company. This raises the issue of whether the reporting election should be extended to include income from patents or other kinds of intangible property. Second, the Department noted that although the current law is intended to allow only taxpayers who comply with the law to benefit from the royalty filing election but in fact also allows taxpayers who do not report or pay tax on the income to take advantage of the election after the Department discovers the absence of the income. The Department strongly recommended that the Committee consider allowing taxpayers to exercise the royalty reporting option only on a timely filed return. If a timely filed return reporting the royalty income is not filed by the entity receiving the royalty payments, the law should require the royalty payer to forgo its deduction for royalty payments to related members by adding the royalty payments to federal taxable income. The Committee was generally supportive of amending the law to bring it within

---

<sup>6</sup> S.L. 2001-327, s. 4(a).

the original intent of the 2001 act, so that only taxpayers who comply with the law on a timely basis can benefit from the election, but the Committee did not have time to act on this recommendation.

The Department noted in all three of its reports that tax practitioners have discovered an alternative entity structure to overcome the legislature's attempt to close the franchise tax loophole. The Department suggested consideration be given to extending the franchise tax to LLCs and partnerships. Some Committee members raised a second solution: the repeal of the franchise tax, and consequently an overhaul of the State's corporate income and franchise tax law. The Governor's Commission on the Modernization of State Finances also recommended modernizing the State's franchise tax. The Committee did not have time to develop this issue before the convening of the 2003 General Assembly, but noted that the issue needs to be addressed.

The 2001 legislation amended several sections of the State tax law to generally conform to the federal tax treatment of dividend income. One of the changes was the repeal of G.S. 105-130.7(b), which addressed subsidiary dividends. The Department recommends that G.S. 105-130.7(a), which addresses dividends received from a regulated investment company or a real estate investment trust, be repealed. Legislative Proposal 6, *Revenue Administrative Changes*, contains a section repealing this provision.

Lastly, in the area of income tax law, the Revenue Laws Study Committee considered special apportionment rules for publishing and broadcasting. Corporations doing business in more than one state must allocate and apportion their income among the states in which they do business according to the respective states' apportionment formulas. Martha Walston, with the Fiscal Research Division, explained North Carolina's apportionment formulas. She noted that the State has special apportionment formulas for certain types of business, such as railroad companies, telephone companies, motor carriers, public utilities, and air or water transportation companies. Appendix J contains a copy of her remarks. The Department of Revenue recommends changing the apportionment rules for publishing companies and broadcasting companies. The Department recommends that

North Carolina's apportionment rules for these two industries be changed to conform to the model apportionment regulations adopted by the Multistate Tax Commission in 1990 and 1993, and amended in 1996. Appendix K contains a copy of the model regulations adopted by the Multistate Tax Commission and Appendix L contains a list of the states that have adopted all or a portion of the Commission's regulations. The Department's recommendation is included in Appendix M. Legislative Proposal 2, *Update Corporate Tax Apportionment Formula*, contains the Committee's recommendation on this issue. The Committee notes that some of the interested parties have questions about the recommendation and acknowledges that it had insufficient time to answer the questions before the convening of the 2003 General Assembly. The Committee decided to recommend the idea to the 2003 General Assembly where the issue may continue to be addressed.

### **ESTATE TAX**

Until 1999 North Carolina imposed an inheritance tax on property transferred by a decedent. The amount of tax due 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.

As part of the budget bill in 1998 (S.L. 1998-212) the General Assembly repealed the inheritance tax for decedents dying on or after January 1, 1999, and in its place enacted an estate tax. North Carolina's estate tax is what is commonly known as a "pick-up tax". The amount of state estate tax due is the maximum amount of the federal credit allowed under the Code for federal estate tax purposes.

In 2001 Congress enacted several major changes to the federal estate tax that could have a substantial impact on the North Carolina estate tax. First, Congress gradually increased the amount of the estate that is excluded from taxation.<sup>7</sup> Second, Congress repealed the estate tax effective in 2010.<sup>8</sup> Third, Congress phased out the federal credit over four years.<sup>9</sup>

In 2002 the General Assembly addressed this issue by partially conforming to the federal changes. North Carolina conformed to the increased exclusion amounts. Thus, as under previous law, an estate that is not subject to the federal estate tax will not be subject to the state estate tax. However, North Carolina did not conform to the phase-out of the federal credit. For decedents dying in 2002 and 2003, the amount of the North Carolina estate tax will be computed based on the federal credit without regard to the phase-out. Without further legislative action, North Carolina will conform to the phase out as of January 1, 2004, and the North Carolina estate tax will, for practical purposes, cease to exist beginning in 2005. Finally, North Carolina did conform to the 2010 repeal of the estate tax.

North Carolina was not alone in facing this issue in 2002. At the time of the federal changes in 2001, all 50 states and the District of Columbia had a state estate or inheritance tax that relied on the federal credit to some degree.<sup>10</sup> In 2002, a number of states took legislative action (or declined to

---

<sup>7</sup> For 2001, the applicable exclusion amount was \$675,000. That amount was increased to \$1 million for 2002 and 2003, to \$1.5 million for 2004, and 2005, to \$2 million for 2006 through 2008, and to \$3.5 million for 2009.

<sup>8</sup> However, without further Congressional action, the federal estate tax will be reinstituted automatically in 2011.

<sup>9</sup> The amount of the credit was reduced 25% for 2002, 50% for 2003, 75% for 2004, and eliminated in 2005.

<sup>10</sup> Thirty-eight states, including North Carolina, had a straight pick-up tax. The other 13 states used the state death tax credit as a supplemental tax or as an alternative minimum tax.



take action) to offset the effects of the phase-out. Eleven states, including North Carolina, took affirmative steps to decouple from the phase-out of the federal credit.<sup>11</sup> An additional 6 states and the District of Columbia decided not to update their reference to the Code for purposes of the federal credit. Nebraska enacted a freestanding estate tax that tracks federal definitions and has a rate schedule identical to that of the federal credit as it existed in 2001. On the other hand, New Hampshire repealed its separate inheritance tax effective for 2003. Without further changes to state law, by 2005 30 states will have no estate or inheritance tax, 10 states will have a pick-up tax based on the 2001 credit, and 11 states will have a stand-alone estate or inheritance tax.

The Revenue Laws Study Committee acknowledges that the 2003 General Assembly will need to address this issue and notes that North Carolina has essentially five options in regards to the estate tax:

- North Carolina could extend or remove the sunset on the decoupling from the phase-out of the federal credit. Under current law, North Carolina will conform to the phase-out of the federal credit beginning in 2004. The General Assembly could choose to permanently tie the amount of the state estate tax to the amount of the federal credit that existed in 2001. This would preserve state revenue in the near future, but it would be more difficult administratively for taxpayers. This is only a temporary solution since the federal estate tax is set to be repealed altogether in 2010.
- North Carolina could take no action, thereby conforming to the phase-out of the federal credit beginning in 2004. This option could lead to lower state revenue as early as the 2003-2004 fiscal year and would result in an effective elimination of the state estate tax beginning January 1, 2005.
- North Carolina could move away from the pick-up tax and establish a stand-alone estate or inheritance tax. This tax could be structured to be revenue neutral or to result in a revenue gain or a revenue loss.
- North Carolina could fully conform to the federal changes now. This option could lead to lower state revenues immediately.

---

<sup>11</sup> North Carolina decoupled from the federal legislation only temporarily. Under current law, North Carolina is set to conform to the federal legislation as of January 1, 2004. The other ten states that actively decoupled must take further legislative action to conform to the federal legislation.

- North Carolina could repeal the estate tax. This option could lead to lower state revenues immediately.

## **SALES TAX**

The Revenue Laws Study Committee continues to support the efforts of and monitor the progress of the Streamlined Sales Tax Project. The Project is an effort created by state governments, with input from local governments and the private sector, to simplify and modernize sales and use tax administration for both Main Street and remote sellers for all types of commerce. Thirty-nine of the 45 states with a sales and use tax, as well as the District of Columbia, are involved in the Project.

The Project envisions two components to the legislation necessary to accomplish its goals. First, states would adopt enabling legislation referred to as the Uniform Sales and Use Tax Administration Act. The Act allows the state to enter into an agreement with one or more states to simplify and modernize sales and use tax administration in order to reduce the burden of tax compliance for all sellers and all types of commerce. Thirty-five states and the District of Columbia have enacted the Uniform Sales and Use Tax Administration Act. Secondly, states would amend or modify their sales and use tax law to achieve the simplifications and uniformity required by the participating state working together. The Project refers to this legislation as the Streamlined Sales and Use Tax Agreement. A certificate of compliance will document each state's compliance with the provisions of the Agreement.

The Revenue Laws Study Committee has recommended, and the General Assembly has enacted, both the Uniform Sales and Use Tax Administration Act and many provisions in the Streamlined Sales and Use Tax Agreement.<sup>12</sup> As of November 12, 2002, representatives of 33 states and the District of Columbia voted to approve the final version of the Streamlined Sales and Use Tax Agreement. The provisions in the Agreement cover many issues, including the following:

- Single tax base

---

<sup>12</sup> S.L. 2000-120 and S.L. 2001-347.

- Reduction of multiple rates
- Uniform definitions for exemptions
- Uniform sourcing
- Limitations on sales tax holidays
- Elimination of caps and thresholds

The Revenue Laws Study Committee recognizes that some of the issues remaining for the State to address will be difficult ones. For example, the exemption of food from part of the local tax base violates the provision concerning uniform tax bases and the 1%, \$80 cap on certain types of equipment violates the provision concerning the elimination of caps and thresholds. The Committee did not have adequate time to devote to these difficult policy decisions. Legislative Proposal 3, *Streamlined Sales and Use Tax Agreement*, includes a few modifications to the State's sales and use tax statutes needed to conform to the Agreement adopted in November 2002. The Committee encourages the General Assembly to give consideration to the other statutory changes that are needed to conform to the Agreement. A copy of the Agreement is contained in the Committee's Notebook and may be found on the Internet at [www.geocities.com/streamlined2000](http://www.geocities.com/streamlined2000).

Currently, all major State agencies except the Department of Transportation<sup>13</sup>, are subject to State and local sales taxes. However, the State receives a refund of the local sales taxes paid by its agencies, with the proceeds of the refund going to the General Fund. Refunds for purchases by the constituent institutions of the University of North Carolina are made on an annual basis and refunded directly to the state agency. The current refund process is time-consuming for both 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 recommends that the refund process be changed to a sales and use tax exemption for State agencies. Legislative Proposal 4, *State Government Sales Tax Exempt*, allows a sales and use tax exemption for State agencies instead of a sales and use tax refund.

---

<sup>13</sup> The Department of Transportation is exempt from State and local sales and use tax.

## **GENERAL TAX LAW ADMINISTRATION CHANGES**

Legislative Proposal 5, *Uniform Tax Refund Procedure*, is the first step in simplifying the refund procedure for all types of taxes and purposes. Currently, the process differs depending on the reason for which a refund is claimed. The North Carolina Bar Association and the North Carolina Association of CPAs have expressed an interest in a uniform procedure. However, the Committee acknowledges that it did not have time to consult with these interested parties before its final meeting. The Committee recommends Legislative Proposal 5 as the starting point for discussions among the interested parties during the consideration of this issue during the 2003 Session.

The Revenue Laws Study Committee recommends Legislative Proposal 6, *Revenue Administrative Changes*. This proposal incorporates several suggestions from the Department of Revenue and others. Legislative Proposal 7, *Revenue Laws Technical Changes*, makes several technical and clarifying changes to the revenue laws and related statutes.

## **COMMITTEE RECOMMENDATIONS AND LEGISLATIVE PROPOSALS**

---

The Revenue Laws Study Committee makes the following seven recommendations to the 2003 General Assembly. Each proposal is followed by an explanation and, if it has a fiscal impact, a fiscal note or memorandum indicating any anticipated revenue gain or loss resulting from the proposal.

1. IRC Update
2. Update Corporate Tax Apportionment Formula
3. Streamlined Sales Tax Changes
4. State Government Sales Tax Exemption
5. Uniform Tax Refund Procedure
6. Revenue Administrative Changes
7. Revenue Laws Technical Changes

# **LEGISLATIVE PROPOSAL #1**

---

**IRC UPDATE**

---

# LEGISLATIVE PROPOSAL 1:

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE  
TO THE 2003 GENERAL ASSEMBLY, 2003 SESSION

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

---

**SHORT TITLE:** IRC Update.

---

**SPONSORS:** **Rep. McComas**, Allen, Hill, Holliman, Luebke, Wainwright  
**Sen. Dalton**, Clodfelter, Hartsell, Hoyle, Kerr

---

**BRIEF OVERVIEW:** This proposal updates to January 1, 2003, the reference to the Internal Revenue Code used in defining and determining certain State tax provisions.

---

**FISCAL IMPACT:** The State's General Fund may realize a gain of less than \$30,000 annually.

---

**EFFECTIVE DATE:** This proposal is effective when it becomes law.

---

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





# BILL ANALYSIS OF LEGISLATIVE PROPOSAL 1: IRC UPDATE

BY: CANAAN HUIE, BILL DRAFTING DIVISION

---

**SUMMARY:** *This bill updates to January 1, 2003 the reference to the Internal Revenue Code used in defining and determining certain state tax provisions. This bill is effective when it becomes law.*

**ANALYSIS:** North Carolina's tax law tracks many provisions of the federal Internal Revenue Code, by reference to the Code.<sup>1</sup> The General Assembly determines each year whether to update its reference to the Internal Revenue Code.<sup>2</sup> 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 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 current law, the reference date to the Code is May 1, 2002.

This bill would update the reference to the Code to January 1, 2003. Congress enacted one bill between May 1, 2002, and January 1, 2003 that would affect State tax provisions. The Clergy Housing Allowance Clarification Act of 2002, P.L. 107-181, enacted on May 20, 2002, 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 that the allowance was used to rent or provide a home for the minister. Under current federal law, the rental allowance is excluded to the extent that it is used to rent or provide a home for the minister and to the extent that it does not exceed the fair market value of the rental.

---

<sup>1</sup> 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.

<sup>2</sup> 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."

This change could have the effect of increasing taxable income for some taxpayers and is therefore required to be roll-called on separate days pursuant to Section 23 of Article II of the North Carolina Constitution.

The federal change became effective for taxable years beginning on or after January 1, 2002. Since this change could have the effect of increasing taxable income for some taxpayers, it could not become effective for taxable years that have already ended. Section 2 of this bill ensures that this change will not increase North Carolina taxable income for any person for the 2002 taxable year.

## **FISCAL ANALYSIS MEMORANDUM**

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

**DATE:** January 17, 2003

**TO:** Revenue Laws Study Committee

**FROM:** Richard Bostic  
Fiscal Research Division

**RE:** IRC Update

### **FISCAL IMPACT**

**Yes (X)**

**No ( )**

**No Estimate Available ( )**

**FY 2003-04**

**FY 2004-05**

**FY 2005-06**

**FY 2006-07**

**FY 2007-08**

#### **REVENUES**

General Fund

Gain of < \$30,000 each year

#### **EXPENDITURES**

#### **PRINCIPAL DEPARTMENT(S) &**

**PROGRAM(S) AFFECTED:** Department of Revenue

**EFFECTIVE DATE:** This act is effective when it becomes law.

**BILL SUMMARY:** This bill updates the statutory reference to the Internal Revenue Code used in defining and determining certain state income tax provisions. The referenced date is changed from May 1, 2002 to January 1, 2003.

**BACKGROUND:** Ordained ministers, rabbis, and cantors do not pay income tax on housing allowances received as part of their compensation for ministerial duties. However, the housing allowance is subject to Social Security and Medicare taxes under the Self-Employment Contributions Act. To remain tax free, the housing allowance must be used to pay rent, to make a down payment on a house, to pay mortgage installments, or to pay utilities, interest, tax, and house repair expenses. The church or local congregation must designate the part of the minister's compensation that is a housing allowance. This designation of the allowance amount must be made in advance of any payments.

The housing allowance is also given to ministers working as teachers or administrators for a parochial school, college, or theological seminary, to retired ministers if furnished in recognition of past services, and to traveling evangelists to maintain a permanent home. Ordained ministers that work as executives of nonreligious organizations are generally barred from using the allowance. Non-ordained church officers such as minister of music and minister of education do not qualify for a housing allowance.

**ASSUMPTIONS AND METHODOLOGY:** The effect of this bill is to conform to a change approved by Congress on May 20, 2002 in the Clergy Housing Allowance Act of 2002 (PL 107-181). This law clarified that the clergy housing allowance is excluded from income tax to the extent that it does not exceed the fair market value of the housing unit. For those that had been claiming housing allowances greater than the fair market value for their property, their taxable income will increase in 2003. The Bureau of Labor Statistics in the US Department of Labor reports 450 clergy in North Carolina making an average salary of \$36,640 and 100 directors of religious activities and education making an average salary of \$27,910. However, there is no data on housing allowances claimed by North Carolina clergy.

The Congressional Joint Committee on Taxation estimated that clergy nationwide would pay an additional \$1million in federal income tax each year beginning in 2004 due to the law change. The amount of additional tax would increase to \$2 million in 2006, \$3 million in 2007, and \$4 million in 2008. Since North Carolina taxable income is based on the federal taxable income, North Carolina will gain a small amount of revenue from this change. State income tax collections divided by national tax collections equals approximately .723%. Using this percentage times the national estimate for the tax change equals the following North Carolina General Fund revenue increase:

FY 2003-04	\$7,230
FY 2004-05	\$7,230
FY 2005-06	\$14,460
FY 2006-07	\$21,690
FY 2007-08	\$28,920

**SOURCES OF DATA:** Congressional Joint Committee on Taxation; Bureau of Labor Statistics

**TECHNICAL CONSIDERATIONS:**

# **LEGISLATIVE PROPOSAL #2**

---

**UPDATE CORPORATE APPORTIONMENT FORMULA**

---

## LEGISLATIVE PROPOSAL 2:

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE  
TO THE 2003 GENERAL ASSEMBLY, 2003 SESSION

### AN ACT TO ADJUST THE APPORTIONMENT FORMULA SALES FACTOR FOR BROADCASTERS AND PUBLISHERS AND TO UPDATE THE APPORTIONMENT FORMULA PROPERTY FACTOR FOR ALL CORPORATIONS BY EXCLUDING OUTER- JURISDICTIONAL PROPERTY FROM THAT FACTOR.

---

**SHORT TITLE:** Update Corporate Tax Apportionment Formula.

---

**SPONSORS:** Sen. Clodfelter, Dalton, Hartsell, Hoyle, Kerr

---

**BRIEF OVERVIEW:** This proposal makes the following three changes to the apportionment formula for corporate income tax:

1. Amends the property factor so that outer-jurisdictional property is excluded from the numerator and denominator of the property factor.
  2. Adds an alternative formula for corporations engaged in the business of broadcasting radio or television programming.
  3. Adds an alternative formula for corporations engaged in the business of publishing, selling, licensing, or distributing newspapers, magazines, trade journals, books, or other publications.
- 

**FISCAL IMPACT:** See Appendix N for an analysis of the revenue changes, prepared by the Tax Research Division of the Department of Revenue.

---

**EFFECTIVE DATE:** This proposal is effective for taxable years beginning on or after January 1, 2003.

---

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

**GENERAL ASSEMBLY OF NORTH CAROLINA**  
**SESSION 2003**

**S**

**D**

**BILL DRAFT 2003-LAzz-1 [v.15] (12/16)**

**(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)**  
**1/29/2003 10:39:31 AM**

Short Title: Update Corporate Tax Apportionment Formula.

(Public)

Sponsors: .

Referred to:

1 A BILL TO BE ENTITLED  
2 AN ACT TO ADJUST THE APPORTIONMENT FORMULA SALES FACTOR  
3 FOR BROADCASTERS AND PUBLISHERS AND TO UPDATE THE  
4 APPORTIONMENT FORMULA PROPERTY FACTOR FOR ALL  
5 CORPORATIONS BY EXCLUDING OUTER-JURISDICTIONAL PROPERTY  
6 FROM THAT FACTOR.

7 The General Assembly of North Carolina enacts:

8 **SECTION 1.** G.S. 105-130.4 reads as rewritten:

9 **"§ 105-130.4. Allocation and apportionment of income for corporations.**

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

11 (1) "Business income" means all income that is apportionable under the  
12 United States Constitution.

13 (1a) Broadcasting. -- Transmitting radio or television programming to  
14 viewers or listeners by an electronic or other signal conducted by  
15 radio waves, microwaves, wires, coaxial cables, fiber optics,  
16 satellite transmissions, or any other means of communication.

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

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

21 (4) "Excluded corporation" means any corporation engaged in business  
22 as a building or construction contractor, a securities dealer, or a loan  
23 company or a corporation that receives more than fifty percent  
24 (50%) of its ordinary gross income from intangible property.



- 1           (4a) General formula. – A fraction, the numerator of which is the  
2           property factor plus the payroll factor plus twice the sales factor,  
3           and the denominator of which is four. If the sales factor does not  
4           exist, the denominator of the fraction is the number of existing  
5           factors. If the sales factor exists but the payroll factor or the  
6           property factor does not exist, the denominator of the fraction is the  
7           number of existing factors plus one.
- 8           (5) "Nonbusiness income" means all income other than business  
9           income.
- 10          (5a) Outer-jurisdictional property. -- Tangible personal property that is  
11          not physically located in any state. The term includes orbiting  
12          satellites and undersea transmission cables.
- 13          (6) "Public utility" means any corporation that is subject to control of  
14          one of more of the following entities: the North Carolina Utilities  
15          Commission, the Federal Communications Commission, the  
16          Interstate Commerce Commission, the Federal Power Commission,  
17          or the Federal Aviation Agency; and that owns or operates for  
18          public use any plant, equipment, property, franchise, or license for  
19          the transmission of communications, the transportation of goods or  
20          persons, or the production, storage, transmission, sale, delivery or  
21          furnishing of electricity, water, steam, oil, oil products, or gas. The  
22          term also includes a motor carrier of property whose principal  
23          business activity is transporting property by motor vehicle for hire  
24          over the public highways of this State. The term does not include a  
25          corporation engaged in the business of broadcasting radio or  
26          television programming.
- 27          (6a) Radio programming. – Any performance, event, or production  
28          broadcast on radio, including news, sporting events, plays, stories,  
29          and other literary, commercial, educational, or artistic works,  
30          through the use of an audio tape, disk, or any other format or  
31          medium. Each episode of a series is considered separately.
- 32          (7) "Sales" means all gross receipts of the corporation except for the  
33          following receipts:  
34              a. Receipts from a casual sale of property.  
35              b. Receipts allocated under subsections (c) through (h) of this  
36              section.  
37              c. Receipts exempt from taxation.  
38              d. The portion of receipts realized from the sale or maturity of  
39              securities or other obligations that represents a return of  
40              principal.

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

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

8 (9a) Television programming.. -- Any performance, event, or production  
9 broadcast on television, including news, sporting events, plays,  
10 stories, and other literary, commercial, educational, or artistic  
11 works, through the use of video tape, disk, or any other format or  
12 medium. Each episode of a series is considered separately.

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

23 (c) Rents and royalties from real or tangible personal property, gains and  
24 losses, interest, dividends less the portion deductible under G.S. 105-130.7, patent  
25 and copyright royalties and other kinds of income, to the extent that they constitute  
26 nonbusiness income, less related expenses shall be allocated as provided in  
27 subsections (d) through (h) of this section.

28 (d) (1) Net rents and royalties from real property located in this State are  
29 allocable to this State.

30 (2) Net rents and royalties from tangible personal property are allocable  
31 to this State:

32 a. If and to the extent that the property is utilized in this State,  
33 or

34 b. In their entirety if the corporation's commercial domicile is in  
35 this State and the corporation is not organized under the laws  
36 of, or is not taxable in, the state in which the property is  
37 utilized.

38 (3) The extent of utilization of tangible personal property in a state is  
39 determined by multiplying the rents and royalties by a fraction, the  
40 numerator of which is the number of days of physical location of  
41 the property in the state during the rental or royalty period in the

1 income year and the denominator of which is the number of days of  
2 physical location of the property everywhere during all rental or  
3 royalty periods in the income year. If the physical location of the  
4 property during the rental or royalty period is unknown or  
5 unascertainable by the corporation, tangible personal property is  
6 utilized in the state in which the property was located at the time the  
7 rental or royalty payer obtained possession.

8 (e) (1) Gains and losses from sales or other disposition of real property  
9 located in this State are allocable to this State.

10 (2) Gains and losses from sales or other disposition of tangible personal  
11 property are allocable to this State if  
12 a. The property had a situs in this State at the time of the sale,  
13 or  
14 b. The corporation's commercial domicile is in this State and  
15 the corporation is not taxable in the state in which the  
16 property has a situs.

17 (3) Gains and losses from sales or other disposition of intangible  
18 personal property are allocable to this State if the corporation's  
19 commercial domicile is in this State.

20 (f) Interest and net dividends are allocable to this State if the corporation's  
21 commercial domicile is in this State. For purposes of this section, the term "net  
22 dividends" means gross dividend income received less related expenses and less that  
23 portion of the dividends deductible under G.S. 105-130.7.

24 (g) (1) Royalties or similar income received from the use of patents,  
25 copyrights, secret processes and other similar intangible property  
26 are allocable to this State:  
27 a. If and to the extent that the patent, copyright, secret process  
28 or other similar intangible property is utilized in this State, or  
29 b. If and to the extent that the patent, copyright, secret process  
30 or other similar intangible property is utilized in a state in  
31 which the taxpayer is not taxable and the taxpayer's  
32 commercial domicile is in this State.

33 (2) A patent, secret process or other similar intangible property is  
34 utilized in a state to the extent that it is employed in production,  
35 fabrication, manufacturing, processing, or other use in the state or to  
36 the extent that a patented product is produced in the state. If the  
37 basis of receipts from such intangible property does not permit  
38 allocation to states or if the accounting procedures do not reflect  
39 states of utilization, the intangible property is utilized in the state in  
40 which the taxpayer's commercial domicile is located.

1           (3) A copyright is utilized in a state to the extent that printing or other  
2 publication originates in the state. If the basis of receipts from  
3 copyright royalties does not permit allocation to states or if the  
4 accounting procedures do not reflect states of utilization, the  
5 copyright is utilized in the state in which the taxpayer's commercial  
6 domicile is located.

7           (h) The income less related expenses from any other nonbusiness activities or  
8 investments not otherwise specified in this section is allocable to this State if the  
9 business situs of the activities or investments are located in this State.

10          (i) Most Corporations. --All business income of corporations other than public  
11 utilities and excluded corporations shall be apportioned to this State by multiplying  
12 the income by a fraction, the numerator of which is the property factor plus the  
13 payroll factor plus twice the sales factor, and the denominator of which is four.  
14 Provided, that where the sales factor does not exist, the denominator of the fraction  
15 shall be the number of existing factors and where the sales factor exists but the  
16 payroll factor or the property factor does not exist, the denominator of the fraction  
17 shall be the number of existing factors plus one. corporations, other than those  
18 corporations that are required to apportion business income under one of the special  
19 formulas provided in subsections (m) through (s2) of this section, is apportioned to  
20 this State by multiplying the income by the general formula.

21          (j) (1) The property factor is a fraction, the numerator of which is the  
22 average value of the corporation's real and tangible personal  
23 property owned or rented and used in this State during the income  
24 year and the denominator of which is the average value of all the  
25 corporation's real and tangible personal property owned or rented  
26 and used during the income year. Neither the numerator nor the  
27 denominator includes outer-jurisdictional property.

28          (2) Property owned by the corporation is valued at its original cost.  
29 Property rented by the corporation is valued at eight times the net  
30 annual rental rate. Net annual rental rate is the annual rental rate  
31 paid by the corporation less any annual rental rate received by the  
32 corporation from subrentals except that subrentals shall not be  
33 deducted when they constitute business income. Any property under  
34 construction and any property the income from which constitutes  
35 nonbusiness income shall be excluded in the computation of the  
36 property factor.

37          (3) The average value of property shall be determined by averaging the  
38 values at the beginning and end of the income year, but in all cases  
39 the Secretary of Revenue may require the averaging of monthly or  
40 other periodic values during the income year if reasonably required  
41 to reflect properly the average value of the corporation's property. A

1 corporation that ceases its operations in this State before the end of  
2 its income year because of its intention to dissolve or to relinquish  
3 its certificate of authority, or because of a merger, conversion, or  
4 consolidation, or for any other reason whatsoever shall use the real  
5 estate and tangible personal property values as of the first day of the  
6 income year and the last day of its operations in this State in  
7 determining the average value of property, but the Secretary may  
8 require averaging of monthly or other periodic values during the  
9 income year if reasonably required to reflect properly the average  
10 value of the corporation's property.

11 (k) (1) The payroll factor is a fraction, the numerator of which is the total  
12 amount paid in this State during the income year by the corporation  
13 as compensation, and the denominator of which is the total  
14 compensation paid everywhere during the income year. All  
15 compensation paid to general executive officers and all  
16 compensation paid in connection with nonbusiness income shall be  
17 excluded in computing the payroll factor. General executive officers  
18 shall include the chairman of the board, president, vice-presidents,  
19 secretary, treasurer, comptroller, and any other officers serving in  
20 similar capacities.

21 (2) Compensation is paid in this State if:

- 22 a. The individual's service is performed entirely within the  
23 State; or  
24 b. The individual's service is performed both within and  
25 without the State, but the service performed without the State  
26 is incidental to the individual's service within the State; or  
27 c. Some of the service is performed in this State and (i) the base  
28 of operations or, if there is no base of operations, the place  
29 from which the service is directed or controlled is in this  
30 State, or (ii) the base of operations or the place from which  
31 the service is directed or controlled is not in any state in  
32 which some part of the service is performed, but the  
33 individual's residence is in this State.

34 (l) (1) The sales factor is a fraction, the numerator of which is the total  
35 sales of the corporation in this State during the income year, and the  
36 denominator of which is the total sales of the corporation  
37 everywhere during the income year. Notwithstanding any other  
38 provision under this Part, the receipts from any casual sale of  
39 property shall be excluded from both the numerator and the  
40 denominator of the sales factor. Where a corporation is not taxable  
41 in another state on its business income but is taxable in another state

only because of nonbusiness income, all sales shall be treated as having been made in this State.

(2) Sales of tangible personal property are in this State if the property is received in this State by the purchaser. In the case of delivery of goods by common carrier or by other means of transportation, including transportation by the purchaser, the place at which the goods are ultimately received after all transportation has been completed shall be considered as the place at which the goods are received by the purchaser. Direct delivery into this State by the taxpayer to a person or firm designated by a purchaser from within or without the State shall constitute delivery to the purchaser in this State.

(3) Other sales are in this State if:

- a. The receipts are from real or tangible personal property located in this State; or
- b. The receipts are from intangible property and are received from sources within this State; or
- c. The receipts are from services and the income-producing activities are in this State.

(m) All business income of a railroad company shall be apportioned to this State by multiplying the income by a fraction, the numerator of which is the "railway operating revenue" from business done within this State and the denominator of which is the "total railway operating revenue" from all business done by the company as shown by its records kept in accordance with the standard classification of accounts prescribed by the Interstate Commerce Commission.

"Railway operating revenue" from business done within this State shall mean "railway operating revenue" from business wholly within this State, plus the equal mileage proportion within this State of each item of "railway operating revenue" received from the interstate business of the company. "Equal mileage proportion" shall mean the proportion which the distance of movement of property and passengers over lines in this State bears to the total distance of movement of property and passengers over lines of the company receiving such revenue. "Interstate business" shall mean "railway operating revenue" from the interstate transportation of persons or property into, out of, or through this State. If the Secretary of Revenue shall find, with respect to any particular company, that its accounting records are not kept so as to reflect with exact accuracy such division of revenue by State lines as to each transaction involving interstate revenue, the Secretary of Revenue may adopt such regulations, based upon averages, as will approximate with reasonable accuracy the proportion of interstate revenue actually earned upon lines in this State. Provided, that where a railroad is being operated by a partnership which is treated as a corporation for income tax purposes and pays a net income tax to this State, or if

1 located in another state would be so treated and so pay as if located in this State, each  
2 partner's share of the net profits shall be considered as dividends paid by a  
3 corporation for purposes of this Part and shall be so treated for inclusion in gross  
4 income, deductibility, and separate allocation of dividend income.

5 (n) All business income of a telephone company shall be apportioned to this  
6 State by multiplying the income by a fraction, the numerator of which is gross  
7 operating revenue from local service in this State plus gross operating revenue from  
8 toll services performed wholly within this State plus the proportion of revenue from  
9 interstate toll services attributable to this State as shown by the records of the  
10 company plus the gross operating revenue in North Carolina from other service less  
11 the uncollectible revenue in this State, and the denominator of which is the total gross  
12 operating revenue from all business done by the company everywhere less total  
13 uncollectible revenue. Provided, that where a telephone company is required to keep  
14 its records in accordance with the standard classification of accounts prescribed by  
15 the Federal Communications Commission the amounts in such accounts shall be used  
16 in computing the apportionment fraction as provided in this subsection.

17 (o) All business income of a motor carrier of property shall be apportioned by  
18 multiplying the income by a fraction, the numerator of which is the number of  
19 vehicle miles in this State and the denominator of which is the total number of  
20 vehicle miles of the company everywhere. The words "vehicle miles" shall mean  
21 miles traveled by vehicles owned or operated by the company hauling property for a  
22 charge or traveling on a scheduled route.

23 (p) All business income of a motor carrier of passengers shall be apportioned  
24 by multiplying the income by a fraction, the numerator of which is the number of  
25 vehicle miles in this State and the denominator of which is the total number of  
26 vehicle miles of the company everywhere. The words "vehicle miles" shall mean  
27 miles traveled by vehicles owned or operated by the company carrying passengers for  
28 a fare or traveling on a scheduled route.

29 (q) All business income of a telegraph company shall be apportioned by  
30 multiplying the income by a fraction, the numerator of which is the property factor  
31 plus the payroll factor plus the sales factor and the denominator of which is three.

32 The property factor shall be as defined in subsection (j) of this section, the payroll  
33 factor shall be as defined in subsection (k) of this section, and the sales factor shall be  
34 as defined in subsection (l ) of this section.

35 (r) All business income of an excluded corporation and of all other public  
36 utilities shall be apportioned by multiplying the income by the sales factor as  
37 determined under subsection (l ) of this section.

38 (s) All business income of an air or water transportation corporation shall be  
39 apportioned by a fraction, the numerator of which is the corporation's revenue ton  
40 miles in this State and the denominator of which is the corporation's revenue ton  
41 miles everywhere. The term "revenue ton mile" means one ton of passengers, freight,

1 mail, or other cargo carried one mile. In making this computation, a passenger is  
2 considered to weigh two hundred pounds.

3 (s1) Broadcasters. -- All business income of a corporation engaged in the  
4 business of broadcasting radio or television programming is apportioned by  
5 multiplying the income by the general formula, after modifying the numerator of the  
6 sales factor in accordance with this section. The numerator includes all receipts from  
7 broadcasting radio and television programming multiplied by an audience factor. For  
8 radio broadcasts and for television broadcasts by a television station, the audience  
9 factor is the ratio of the corporation's North Carolina listening or viewing audience to  
10 the corporation's total listening or viewing audience. For television broadcasts by a  
11 cable television system, the audience factor is the ratio of the cable television  
12 system's subscribers located in this State to all the cable television system's  
13 subscribers. A corporation may use published rating or subscription statistics, as  
14 appropriate, to determine its audience factor.

15 (s2) Publishers. -- All business income of a corporation engaged in the  
16 business of publishing, selling, licensing, or distributing newspapers, magazines,  
17 trade journals, books, or other publications is apportioned by multiplying the income  
18 by the general formula, after modifying the numerator of the sales factor in  
19 accordance with this section. The numerator includes all the corporation's receipts  
20 from advertising and from the sale, rental, or other use of its customer lists multiplied  
21 by a circulation factor. The circulation factor is the ratio of the corporation's North  
22 Carolina purchasers and subscribers of a publication to the corporation's total  
23 purchasers and subscribers of the publication. A purchaser or subscriber of a  
24 publication is the final recipient of the publication. A separate circulation factor  
25 applies to each publication. If advertising in a publication is included only in copies  
26 of the publication distributed to a limited geographic area, the circulation factor is  
27 determined on the basis of the circulation within the limited geographic area. A  
28 corporation may use rating statistics published by the Audit Bureau of Circulations or  
29 other comparable statistics to determine the circulation factor for a publication.

30 (t) (1) If any corporation believes that the method of allocation or  
31 apportionment as administered by the Secretary has operated or will  
32 so operate as to subject it to taxation on a greater portion of its  
33 income than is reasonably attributable to business or earnings within  
34 the State, it may file with the Tax Review Board a petition setting  
35 forth the facts upon which its belief is based and its argument with  
36 respect to the application of the allocation formula. This petition  
37 shall be filed in such form and within such time as the Tax Review  
38 Board may prescribe. The Board shall grant a hearing on the  
39 petition. The time limitations set in G.S. 105-241.2 for the date of  
40 the hearing, notification to the taxpayer, and a decision following  
41 the hearing apply to a hearing held pursuant to this subsection. At



1 least three members of the Tax Review Board shall attend any  
2 hearing pursuant to such petition. In such cases, the Tax Review  
3 Board's membership shall be augmented by the addition of the  
4 Secretary, who shall sit as a member of the Board with full power to  
5 participate in its deliberations and decisions with respect to petitions  
6 filed under the provisions of this subsection. An informal record  
7 containing in substance the evidence, contentions and arguments  
8 presented at the hearing shall be made. All members of the  
9 augmented Tax Review Board shall consider such evidence,  
10 contentions and arguments and the decisions thereon shall be made  
11 by a majority vote of the augmented Board.

12 (2) If the corporation employs in its books of account a detailed  
13 allocation of receipts and expenditures which reflects more clearly  
14 than the applicable allocation formula prescribed by this section the  
15 income attributable to the business within this State, application for  
16 permission to base the return upon the taxpayer's books of account  
17 shall be considered by the Tax Review Board. The Board may  
18 permit such separate accounting method in lieu of applying the  
19 applicable allocation formula if the Board finds that method best  
20 reflects the income and earnings attributable to this State.

21 (3) If the corporation shows that any other method of allocation than  
22 the applicable allocation formula prescribed by this section reflects  
23 more clearly the income attributable to the business within this  
24 State, application for permission to base the return upon such other  
25 method shall be considered by the Tax Review Board. The  
26 application shall be accompanied by a statement setting forth in  
27 detail, with full explanations, the method the corporation believes  
28 will more nearly reflect its income from business within this State.  
29 If the Board concludes that the allocation formula prescribed by this  
30 section allocates to this State a greater portion of the net income of  
31 the corporation than is reasonably attributable to business or  
32 earnings within this State, it shall determine the allocable net  
33 income by such other method as it finds best calculated to assign to  
34 this State for taxation the portion of the corporation's net income  
35 reasonably attributable to its business or earnings within this State.

36 (4) There shall be a presumption that the appropriate allocation formula  
37 reasonably attributes to this State the portion of the corporation's  
38 income earned in this State, and the burden shall rest upon the  
39 corporation to show the contrary. The relief herein authorized shall  
40 be granted by the Board only in cases of clear, cogent and  
41 convincing proof that the petitioning corporation is entitled thereto.

1 No corporation shall use any alternative formula or method other  
2 than the applicable allocation formula provided by statute in making  
3 a report or return of its income to this State except upon order in  
4 writing of the Board, and any return in which any alternative  
5 formula or other method, other than the applicable allocation  
6 formula prescribed by statute, is used without permission of the  
7 Board shall not be a lawful return.

8 When the Board determines, pursuant to the provisions of this  
9 subsection, that an alternative formula or other method more  
10 accurately reflects the income allocable to North Carolina and  
11 renders its decision with regard thereto, the corporation shall  
12 allocate its net income for future years in accordance with such  
13 determination and decision of the Board so long as the conditions  
14 constituting the basis upon which the decision was made remain  
15 unchanged or until such time as the business method of operation of  
16 the corporation changes. Provided, however, that the Secretary may,  
17 with respect to any subsequent year, require the corporation to  
18 furnish information relating to its property, operations, and  
19 activities.

20 (5) A corporation which proposes to do business in this State may file a  
21 petition with the Board setting forth the facts upon which it  
22 contends that the applicable allocation formula will allocate a  
23 greater portion of the corporation's future income to North Carolina  
24 than will be reasonably attributable to its proposed business or  
25 contemplated earnings within the State. Upon a proper showing in  
26 accordance with the procedure described above for determinations  
27 by the Board, the Board may authorize such corporation to allocate  
28 income from its future business to North Carolina on the basis  
29 prescribed by the Board under the provisions of this section for such  
30 future years if the conditions constituting the basis upon which the  
31 Board's decision is made remain unchanged and the business  
32 operations of the corporation continue to conform to the statement  
33 of proposed methods of business operation presented by the  
34 corporation to the Board.

35 (6) When the Secretary asserts liability under the formula adjustment  
36 decision of the Tax Review Board, an aggrieved corporation may  
37 pay the tax and bring a civil action for recovery under the  
38 provisions of Article 9."

39 **SECTION 2.** This act is effective for taxable years beginning on or after  
40 January 1, 2003.  
41

## BILL ANALYSIS OF LEGISLATIVE PROPOSAL 2: UPDATE CORPORATE TAX APPORTIONMENT FORMULA

BY: MARTHA WALSTON, FISCAL RESEARCH DIVISION

---

**SUMMARY:** *This proposal is a Department of Revenue recommendation to amend the allocation and apportionment of income for corporations set out in G.S. 105-130.4 by making the following three changes:*

- 1. Amend the property factor so that outer-jurisdictional property is excluded from the numerator and denominator of the property factor. Outer-jurisdictional property is defined as "tangible personal property that is not physically located in any state." Examples of "outer-jurisdictional property" include orbiting satellites and undersea transmission cables.*
- 2. Add an alternative formula for corporations engaged in the business of broadcasting radio or television programming. The sales factor is amended so that gross receipts, including advertising revenue, are sourced by an audience factor*
- 3. Add an alternative formula for corporations engaged in the business of publishing, selling, licensing, or distributing newspapers, magazines, trade journals, books, or other publications. The sales factor is amended so that gross receipts from advertising and from the sales, rental, or other use of the corporation's customer lists are sourced by a circulation factor.*

**ANALYSIS:** Below is a more detailed description of the changes to G.S. 105-130. 4:  
**The proposal amends subsection (a).** This subsection sets out the definitions used in this statute. The proposal adds the following new definitions: "broadcasting", "general formula", "outer-jurisdictional property", "radio programming", and "television programming". The current definition of "public utility" is amended so that the term does not include a corporation engaged in the business of broadcasting radio or television programming.

**The proposal amends subsection (i).** This subsection sets out the apportionment formula applicable to most corporations. The proposal refers to the special formulas and new definition for "general formula".

**The proposal amends subsection (j).** This subsection describes the property factor used in the general formula for allocation and apportionment of income for corporations. The proposal amends the subsection by excluding outer-jurisdictional property from the numerator and denominator of the property factor.

**The proposal adds a new subsection (s1).** This new subsection provides an alternative apportionment formula for corporations engaged in the business of broadcasting radio or television programming. The new formula modifies the standard sales factor based on a model regulation adopted by the Multistate Tax Commission on August 31, 1990, and amended on April 25, 1996. The new sales factor is calculated using an audience factor:

Gross receipts from broadcasting, including advertising revenue, X audience factor plus other gross receipts

Total gross receipts of the corporation everywhere in income year

The audience factor, for radio broadcasts and television broadcasts, is the ratio of the corporation's NC viewing or listening audience to the corporation's total viewing or listening audience. The audience factor, for television broadcasts by a cable television system, is the ratio of the cable television system's subscribers located in this State to all the cable television system's subscribers.

The Department of Revenue gives the following example of how the audience factor would affect taxpayers:

A national broadcasting company with nexus in NC and several other states owns a television station in Charlotte and generates advertising revenue from Charlotte-area merchants. Twenty percent of the television station's audience is in South Carolina. All of the income producing activities with respect to the advertising is conducted in NC. Under current law, all of the advertising revenue is included in the numerator of the NC sales factor fraction. Under the audience factor provision, twenty percent of the advertising revenue would be excluded from the numerator of the NC sales factor fraction.

**The proposal adds a new subsection (s2).** This new subsection provides an alternative apportionment formula for corporations engaged in the business of publishing, selling, licensing or distributing newspapers, magazines, periodicals, trade journals, or other publications. The new formula modifies the standard sales factor based on a model regulation adopted by the Multistate Tax Commission on July 30, 1993. The following new sales factor is calculated using a circulation factor:

gross receipts from sales of publications to NC purchaser or subscriber + circulation factor X gross receipts from advertising and from sale or use of the corporation's customer list

total gross receipts of corporation everywhere during income year

The circulation factor equals the ratio of the corporation's NC purchasers and subscribers of a publication to the corporation's total purchasers and subscribers of the publication. A separate circulation factor applies to each publication.

The Department of Revenue gives the following example of how the circulation factor would affect taxpayers:

A national publishing company with nexus in NC and several other states generates advertising revenue from one of its magazines. Ten percent of the magazine's subscribers are in NC. All of the income producing activities with respect to the advertising is conducted outside of NC. Under current law, none of the advertising revenue is included in the numerator of the NC sales factor fraction. Under the circulation factor provision, ten percent of the advertising revenue would be included in the numerator of the NC sales factor fraction.

The above changes to G.S. 105-130.4 will also affect the way a corporation apportions its capital stock, surplus, and undivided profits for franchise tax purposes. G.S. 105-122(c)(1) provides that a corporation must apportion its capital stock, surplus, and undivided profits to NC by using the apportionment formula in G.S. 105-130.4. The franchise tax, one of the oldest NC taxes, 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 largest of (1) the amount of capital stock, surplus, and undivided profits apportionable to the State, (2) 55% of the appraised value of all real and tangible personal property in the State that is subject to local property taxation, or (3) the total actual investment in tangible property in the State.

# **LEGISLATIVE PROPOSAL #3**

---

## **STREAMLINED SALES TAX CHANGES**

---

## LEGISLATIVE PROPOSAL 3:

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE  
TO THE 2003 GENERAL ASSEMBLY, 2003 SESSION

### AN ACT TO ADOPT THE STREAMLINED SALES TAX CHANGES.

---

---

**SHORT TITLE:** Streamlined Sales Tax Changes.

---

---

**SPONSORS:** **Rep. Luebke**, Allen, Hill, Holliman, Wainwright  
**Sen. Kerr**, Clodfelter, Dalton, Hartsell, Hoyle

---

---

**BRIEF OVERVIEW:** This proposal adopts the uniform definition of "drug", "prescription", and "over-the-counter drug" contained in the Streamlined Sales and Use Tax Agreement. The change in the definition does not change the taxability of drugs for North Carolina sales and use tax purposes. Prescription drugs and over-the-counter drugs issued on a prescription continue to be exempt from North Carolina sales and use tax.

---

---

**FISCAL IMPACT:** No impact.

---

---

**EFFECTIVE DATE:** This proposal becomes effective July 1, 2003.

---

---

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

**GENERAL ASSEMBLY OF NORTH CAROLINA  
SESSION 2003**

**S**

**D**

**BILL DRAFT 2003-SCz-2 [v.3] (1/24)**

**(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)  
1/24/2003 1:33:49 PM**

Short Title: Streamlined Sales Tax Changes.

(Public)

---

Sponsors:

---

Referred to:

---

A BILL TO BE ENTITLED  
AN ACT TO ADOPT THE STREAMLINED SALES TAX CHANGES.

The General Assembly of North Carolina enacts:

**SECTION 1.** G.S. 105-163.3 is amended by adding the following new subsections to read:

"(8a) Drug. – A compound, substance or preparation or a component of one of these that meets any of the following descriptions and is not food, a dietary supplement, or an alcoholic beverage:

a. Is recognized in the United States Pharmacopoeia, Homeopathic Pharmacopoeia of the United States, or National Formulary.

b. Is intended for use in the diagnosis, cure, mitigation, treatment, or prevention of disease.

c. Is intended to affect the structure of the body.

...

(25a) Over-the-counter-drug. – A drug that can be dispensed under federal law without a prescription and is required by 21 C.F.R. section 210.66 to have a label containing a "Drug Facts" panel and a statement of its active ingredients."

**SECTION 2.** G.S. 106-164.3(29) reads as rewritten:

"(29) ~~Prescription drug. – 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".~~ Prescription. – An order, formula, or recipe issued orally, in writing, electronically, or by another



1 means of transmission by a physician, dentist, veterinarian, or another person  
2 licensed to prescribe drugs."

3 **SECTION 3.** G.S. 105-164.13(13) reads as rewritten:

4 "(13) All of the following drugs, including ~~the constituent elements~~  
5 ~~and ingredients used to produce the drugs, the~~ their  
6 packaging ~~materials,~~ materials and any instructions or  
7 information about the ~~product~~ drugs included in the package  
8 with ~~the drugs:~~ them:

9 a. ~~Prescription drugs.~~ Drugs required by federal law to be  
10 dispensed only on prescription.

11 b. ~~Nonprescription drugs sold on prescription of physicians,~~  
12 ~~dentists, or veterinarians.~~ Over-the-counter drugs sold on  
13 prescription.

14 c. Insulin."

15 **SECTION 4.** This act is effective July 1, 2003.  
16

## BILL ANALYSIS OF LEGISLATIVE PROPOSAL 3: STREAMLINED SALES TAX CHANGES

BY: CINDY AVRETTE, RESEARCH DIVISION

---

**SUMMARY:** *Legislative Proposal 3 adopts the uniform definition of "drug", "prescription", and "over-the-counter drug" contained in the Streamlined Sales and Use Tax Agreement. The change in definition does not change the taxability of drugs for North Carolina sales and use tax purposes. Prescription drugs and over-the-counter drugs issued on a prescription continue to be exempt from North Carolina sales and use tax.*

**BACKGROUND:** The Streamlined Sales Tax Project is an effort created by state governments, with input from local governments and the private sector, to simplify and modernize sales and use tax administration for both Main Street and remote sellers for all types of commerce. Thirty-nine of the forty-five states with a sales and use tax, as well as the District of Columbia, are involved in the Project.

The Project envisions two components to the legislation necessary to accomplish its goals. First, states would adopt enabling legislation referred to as the Uniform Sales and Use Tax Administration Act. The Act allows the state to enter into an agreement with one or more states to simplify and modernize sales and use tax administration in order to reduce the burden of tax compliance for all sellers and all types of commerce. Thirty-five states and the District of Columbia have enacted the Uniform Sales and Use Tax Administration Act. Secondly, states would amend or modify their sales and use tax law to achieve the simplifications and uniformity required by the participating state working together. The Project refers to this legislation as the Streamlined Sales and Use Tax Agreement. A certificate of compliance will document each state's compliance with the provisions of the Agreement. The Agreement takes effect when at least 10 states comprising at least 20 percent 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. The Agreement will take effect on the first day of a calendar quarter at least 60 days after the tenth state is found in compliance, but cannot take effect prior to July 1, 2003.

The Revenue Laws Study Committee has recommended, and the General Assembly has enacted, both the Uniform Sales and Use Tax Administration Act and many provisions in the Streamlined Sales and Use Tax Agreement.<sup>1</sup> As of

---

<sup>1</sup> S.L. 2000-120 and S.L. 2001-347.

November 12, 2002, representatives of 33 states and the District of Columbia voted to approve the final version of the Streamlined Sales and Use Tax Agreement. The provisions in the Agreement cover many issues, including the following:

- Single tax base
- Reduction of multiple rates
- Uniform definitions for exemptions
- Uniform sourcing
- Limitations on sales tax holidays
- Elimination of caps and thresholds

**BILL ANALYSIS:** Legislative Proposal 3 adopts only one change necessitated by the Agreement: it adopts the uniform definitions for the terms "drug", "prescription", and "over-the-counter drug". The proposal does not change the taxability of drugs for North Carolina sales and use tax purposes.

Although North Carolina has adopted many of the provisions in the Agreement, it will need to address several others before it can be found to be in compliance with the Agreement adopted in November 2002. Some of the issues remaining for the State to address include:

- The exemption of food from part, but not all, of the local tax base.
- The 1%, \$80 cap on certain types of equipment.
- The uniform definition of computer software.

## **FISCAL ANALYSIS MEMORANDUM**

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

**DATE:** February 7, 2003

**TO:** Revenue Laws Study Committee

**FROM:** Linda Struyk Millsaps  
Fiscal Research Division

**RE:** Legislative Proposal 3: Streamlined Sales Tax Changes

### **FISCAL IMPACT**

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

**FY 2003-04**   **FY 2004-05**   **FY 2005-06**   **FY 2006-07**   **FY 2007-08**

**REVENUES**

**\*See Assumptions and Methodology\***

**EXPENDITURES**

**POSITIONS:**

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

**EFFECTIVE DATE:**

**BILL SUMMARY:** Under the U.S. Supreme Court decision in *Belle Hess and Quill* states cannot require out of state retailers to collect sales tax on purchases delivered into their state, as it was determined to create an undo burden on those out of state businesses. In an attempt

reduced the potential burden on out of state retailers and capture this potential revenue stream the states are in the process of developing a uniform streamlined sales agreement with common definitions, terms and processes. North Carolina has been involved in the Streamlined Sales Tax Project for several years and has been a signatory of the agreement since 2000. This bill incorporates some of the newest changes to that agreement proposed by the multi-state Streamlined Sales Tax Project participants. Specifically, it provides definitions of the terms “drug”, “prescription”, and “over-the-counter drug”.

**ASSUMPTIONS AND METHODOLOGY:** Because the proposal does not change the taxability of drugs in North Carolina for sales and use tax purposes, no significant sales tax revenue change is expected. There may be some small shift if the new definitions change the taxability of particular subsets of these categories, such as shampoos purchased under prescription, but since it is unclear to Fiscal Research what, if any, products might change categories, no specific fiscal estimate is possible. The Department of Revenue expects whatever shift occurs to be extremely small.

**SOURCES OF DATA:** North Carolina Department of Revenue.

# **LEGISLATIVE PROPOSAL #4**

---

## **STATE GOVERNMENT SALES TAX EXEMPTION**

---

## LEGISLATIVE PROPOSAL 4:

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE  
TO THE 2003 GENERAL ASSEMBLY, 2003 SESSION

### 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.

---

---

**SHORT TITLE:** State Government Sales Tax Exemption.

---

---

**SPONSORS:** **Rep. Allen,** Hill, Holliman, Luebke, McComas, Wainwright  
**Sen. Kerr,** Clodfelter, Dalton, Hartsell, Hoyle

---

---

**BRIEF OVERVIEW:** This proposal exempts direct purchases by State agencies from the State and local sales tax. State agencies must currently apply for a refund of local sales taxes.

---

---

**FISCAL IMPACT:** The loss to the General Fund of sales tax monies paid by State agencies on direct purchases of tangible personal property would be offset by the reduction in State expenditures needed to pay the sales taxes.

---

---

**EFFECTIVE DATE:** The sales and use tax exemption would become effective July 1, 2004, and apply to sales made on or after that date.

---

---

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

**GENERAL ASSEMBLY OF NORTH CAROLINA**  
**SESSION 2003**

**S**

**D**

**BILL DRAFT 2003-SCz-1 [v.6] (1/24)**

**(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)**  
**2/12/2003 4:04:48 PM**

Short Title: State Govt. Sales Tax Exempt.

(Public)

---

Sponsors:

---

Referred to:

---

1 A BILL TO BE ENTITLED  
2 AN ACT TO PROMOTE EFFICIENCY IN STATE GOVERNMENT BY  
3 ALLOWING A SALES AND USE TAX EXEMPTION FOR STATE  
4 AGENCIES INSTEAD OF A SALES AND USE TAX REFUND TO STATE  
5 AGENCIES.

6 The General Assembly of North Carolina enacts:

7 **SECTION 1.** G.S. 105-164.13 is amended by adding a new subdivision to  
8 read:

9 "**§ 105-164.13. Retail sales and use tax.**

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

13 ...

14 (51) Items subject to sales and use tax under G.S. 105-164.4, other than  
15 electricity and telecommunications service, if all of the following  
16 conditions are met:

17 a. The items are purchased by a State agency.

18 b. The items purchased are paid for by a check, credit card,  
19 procurement card, or credit account of the State agency.

20 c. The items are purchased pursuant to a purchase order of the  
21 State agency signed by the person authorized to sign checks  
22 for the agency that contains the exemption number of the  
23 agency and a description of the property purchased."

24 **SECTION 2.** G.S. 105-164.14(c) reads as rewritten:



1       "(c) Certain Governmental Entities. – A governmental entity listed in this  
2 subsection is allowed an annual refund of sales and use taxes paid by it under this  
3 ~~Article, except under G.S. 105-164.4(a)(4a) and G.S. 105-164.4(a)(4e), Article~~ on  
4 direct purchases of tangible personal property, property and services, other than  
5 electricity and telecommunications service. Sales and use tax liability indirectly  
6 incurred by a governmental entity on building materials, supplies, fixtures, and  
7 equipment that become a part of or annexed to any building or structure that is owned  
8 or leased by the governmental entity and is being erected, altered, or repaired for use  
9 by the governmental entity is considered a sales or use tax liability incurred on direct  
10 purchases by the governmental entity for the purpose of this subsection. A request for  
11 a refund must be in writing and must include any information and documentation  
12 required by the Secretary. A request for a refund is due within six months after the  
13 end of the governmental entity's fiscal year.

14       This subsection applies only to the following governmental entities:

- 15           (1) A county.
- 16           (2) A city as defined in G.S. 160A-1.
- 17           (2a) A consolidated city-county as defined in G.S. 160B-2.
- 18           (2b) A local school administrative unit.
- 19           (3) A metropolitan sewerage district or a metropolitan water district in  
20 this State.
- 21           (4) A water and sewer authority created under Chapter 162A of the  
22 General Statutes.
- 23           (5) A lake authority created by a board of county commissioners  
24 pursuant to an act of the General Assembly.
- 25           (6) A sanitary district.
- 26           (7) A regional solid waste management authority created pursuant to  
27 G.S. 153A-421.
- 28           (8) An area mental health, developmental disabilities, and substance  
29 abuse authority, other than a single-county area authority,  
30 established pursuant to Article 4 of Chapter 122C of the General  
31 Statutes.
- 32           (9) A district health department, or a public health authority created  
33 pursuant to Part 1A of Article 2 of Chapter 130A of the General  
34 Statutes.
- 35           (10) A regional council of governments created pursuant to G.S.  
36 160A-470.
- 37           (11) A regional planning and economic development commission or a  
38 regional economic development commission created pursuant to  
39 Chapter 158 of the General Statutes.
- 40           (12) A regional planning commission created pursuant to G.S.  
41 153A-391.

- (13) A regional sports authority created pursuant to G.S. 160A-479.
- (14) A public transportation authority created pursuant to Article 25 of Chapter 160A of the General Statutes.
- (14a) A facility authority created pursuant to Part 4 of Article 20 of Chapter 160A of the General Statutes.
- (15) A regional public transportation authority created pursuant to Article 26 of Chapter 160A of the General Statutes, or a regional transportation authority created pursuant to Article 27 of Chapter 160A of the General Statutes.
- (16) A local airport authority that was created pursuant to a local act of the General Assembly.
- (17) A joint agency created by interlocal agreement pursuant to G.S. 160A-462 to operate a public broadcasting television station.
- (18) Repealed by Session Laws 2001-474, s. 7.
- (19) Repealed by Session Laws 2001-474, s. 7.
- ~~(20) A constituent institution of The University of North Carolina, but only with respect to sales and use tax paid by it for tangible personal property acquired by it through the expenditure of contract and grant funds.~~
- ~~(21) The University of North Carolina Hospitals at Chapel Hill.~~
- (22) A regional natural gas district created pursuant to Article 28 of Chapter 160A of the General Statutes."

**SECTION 3.** G.S. 105-164.14(e) reads as rewritten:

"(e) State Agencies. – The State is allowed quarterly refunds of local sales and use taxes paid by a State agency on direct purchases of tangible personal property and local sales and use taxes paid indirectly by the State agency on building materials, supplies, fixtures, and equipment that become a part of or annexed to a building or structure that is owned or leased by the State agency and is being erected, altered, or repaired for use by the State agency. ~~This subsection does not apply to purchases for which a State agency is allowed a refund under subsection (c) of this section.~~

A person who pays local sales and use taxes on building materials or other tangible personal property for a State building project shall give the State agency for whose project the property was purchased a signed statement containing all of the following information:

- (1) The date the property was purchased.
- (2) The type of property purchased.
- (3) The project for which the property was used.
- (4) If the property was purchased in this State, the county in which it was purchased.

1           (5) If the property was not purchased in this State, the county in which  
2           the property was used.

3           (6) The amount of sales and use taxes paid.

4           If the property was purchased in this State, the person shall attach a copy of the  
5           sales receipt to the statement. A State agency to whom a statement is submitted shall  
6           verify the accuracy of the statement.

7           Within 15 days after the end of each calendar quarter, every State agency shall  
8           file with the Secretary a written application for a refund of taxes to which this  
9           subsection applies paid by the agency during the quarter. The application shall  
10          contain all information required by the Secretary. The Secretary shall credit the local  
11          sales and use tax refunds directly to the General Fund."

12          **SECTION 4.** Part 5 of Article 5 of Chapter 105 of the General Statutes is  
13          amended by adding a new section to read:

14          **"§ 105-164.29A. State government exemption process.**

15          (a) Application. – To be eligible for the exemption provided in G.S. 105-  
16          164.13(47), a State agency must obtain from the Department of Revenue a sales tax  
17          exemption number. The application for exemption must be in the form required by  
18          the Secretary, be signed by the State agency's head, and contain any information  
19          required by the Secretary. The Secretary must assign a sales tax exemption number to  
20          a State agency that submits a proper application.

21          (b) Liability. – A State agency that does not use the items purchased with its  
22          exemption number must pay the tax that should have been paid on the items  
23          purchased, plus interest calculated from the date the tax would otherwise have been  
24          paid."

25          **SECTION 5.** The Office of State Budget and Management must reduce  
26          each State agency's certified budget for fiscal years 2003-04 and 2004-05 by an  
27          appropriate amount to reflect the tax savings generated by the sales and use tax  
28          exemption for State agencies allowed under this act.

29          **SECTION 6.** Section 4 of this act becomes effective January 1, 2004.  
30          The remainder of this act becomes effective July 1, 2004, and applies to sales made  
31          on or after that date.

## BILL ANALYSIS OF LEGISLATIVE PROPOSAL 4: STATE GOVERNMENT SALES TAX EXEMPTION

BY: CINDY AVRETTE, RESEARCH DIVISION

---

**SUMMARY:** *Legislative Proposal 4 exempts purchases by State agencies from the State and local sales tax. State agencies must currently apply for a refund of local sales taxes. The exemption, versus the refund, would become effective July 1, 2004.*

**CURRENT LAW:** Currently, all major State agencies except the Department of Transportation<sup>1</sup>, is subject to State and local sales taxes. However, the State receives a refund of the local sales taxes paid by its agencies, with the proceeds of the refund going to the General Fund. Refunds for purchases by the constituent institutions of the University of North Carolina, the North Carolina Low Level Radioactive Waste Management Authority, the North Carolina Hazardous Waste Management Commission, and the University of North Carolina Hospitals at Chapel Hill are made on an annual basis and refunded directly to the state agency.

**BILL ANALYSIS:** The current refund process is time-consuming for both 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 recommends that the refund process be changed to a sales and use tax exemption for State agencies.

Legislative Proposal 4 changes the current refund process to an exemption. To qualify for the exemption, the following conditions must be met:

- The items must be purchased by a State agency.
- The items purchased must be paid for by a check, credit card, procurement card, or credit account of a State agency.
- The items must be purchased pursuant to a purchase order of the State agency signed by the person authorized to sign checks for the agency. The purchase order must contain the exemption number of the agency and a description of the items purchased. To receive an exemption number, the State agency must apply for one from the Department of Revenue. The application must be signed by the State agency's head and contain any information required by the Secretary.

---

<sup>1</sup> The Department of Transportation is exempt from State and local sales and use tax.

The sales tax exemption would apply only to direct purchases of tangible personal property. State agencies would 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 would be liable for items purchased with its exemption number that it does not use. The liability would 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.

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.

## **FISCAL ANALYSIS MEMORANDUM**

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

**DATE:** January 27, 2003

**TO:** Revenue Laws Study Committee

**FROM:** Linda Struyk Millsaps  
Fiscal Research Division

**RE:** State Agency Sales Tax Exemption

<b>FISCAL IMPACT</b>					
	<b>Yes (X)</b>	<b>No ( )</b>	<b>No Estimate Available ( )</b>		
	<b><u>FY 2003-04</u></b>	<b><u>FY 2004-05</u></b>	<b><u>FY 2005-06</u></b>	<b><u>FY 2006-07</u></b>	<b><u>FY 2007-08</u></b>
<b>REVENUES</b>					
<b>General Fund</b>	(33.5)	(34.6)	(35.9)	(37.1)	(38.4)
<b>EXPENDITURES</b>					
<b>State Agencies</b>	(25.2)	(25.7)	(26.3)	(26.8)	(27.3)
<b>UNC Hospitals</b>	(8.3)	(8.9)	(9.6)	(10.3)	(11.1)
<b>TOTAL</b>	(33.5)	(34.6)	(35.9)	(37.1)	(38.4)
<b>PRINCIPAL DEPARTMENT(S) &amp; PROGRAM(S) AFFECTED:</b> State agencies, UNC Constituent Institutions, UNC Hospitals.					
<b>EFFECTIVE DATE:</b> July 1, 2003					

**BILL SUMMARY:** Under current law purchases by all major state agencies but one are subject to state and local sales taxes, unless the item purchased is exempt from tax for all

purchasers. (The Department of Transportation is exempt from all local and state tax). However, the State receives a refund of the local sales taxes paid by its agencies, with the proceeds of this refund going to the general fund. Most state agencies file on a quarterly basis. Refunds of state and local taxes on purchases by the North Carolina Low Level Radioactive Waste Management Authority, the North Carolina Hazardous Waste Management Commission, constituent institutions of the University of North Carolina, and the University of North Carolina Hospitals at Chapel Hill are made on an annual basis and are refunded directly to the state agency. This bill exempts all state agencies from state and local sales tax. In order to qualify for the exemption a state agency must obtain a sales tax exemption number from the Department of Revenue. If the state agency does not use the items purchased with its number it is liable for the tax on that item. State agencies will continue to file quarterly for a refund of local sales taxes on indirect purchases. The Office of Management and Budget is charged with reducing 2003-04 agency allocations to reflect this change.

**ASSUMPTIONS AND METHODOLOGY:** This legislation will affect both revenues and expenditures.

**REVENUES:** According to the Department of Revenue, for FY 1999-00 state agency refunds of local taxes (excluding the UNC Hospitals) to the General Fund totaled \$14.2 million. Based that refund data, Tax Research estimates that state agencies paid \$42.6 million in state and local sales taxes in 1999-00. Due to continuing budget and agency allocation reductions, actual refunds for local sales taxes paid on agency direct purchases in 2001-02 dropped to approximately \$8.5 million, suggesting that state agencies (excluding UNC Hospitals) paid a total of approximately \$27.3 million in state and local sales taxes on direct purchases (\$8.5 million in local taxes, \$18.6 million in state taxes, \$0.2 million in Mecklenburg additional ½ cent taxes). Given the current budget situation, it is assumed that agency purchases decline again in 2002-03 and 2003-04 and then slowly increase in the out years. Estimated potential state agency refunds for sales that occur in a given fiscal year are as follows:

	<b>State</b>	<b>Local</b>	<b>Mecklenburg</b>	<b>TOTAL</b>
2001-02	18,607,329	8,546,907	181,346	27,335,581
2002-03	18,269,013	9,134,507	172,279	27,575,799
2003-04	15,427,167	9,641,979	163,665	25,232,811
2004-05	15,735,710	9,834,819	166,938	25,737,467
2005-06	16,050,424	10,031,515	170,277	26,252,216
2006-07	16,371,433	10,232,146	173,682	26,777,261
2007-08	16,698,862	10,436,789	177,156	27,312,806

The amounts for 2003-04 and 2004-05 are the amounts that are anticipated to be backed out of individual agencies by the Office of State Budget and Management in their budget certification process.

The above analysis does not include the UNC Hospitals, although they will be affected by the legislation. According to returns filed with the Department of Revenue, UNC Hospitals paid \$7,043,970 in sales tax in 2001-02 on direct purchases. Under the legislation, these sales would now become tax-exempt. Historic data on sales tax refund claims filed by UNC Hospitals indicates that over the past three years claim amounts have grown by an average of 7.6%. Using this historic rate to estimate future potential claims suggests the following potential UNC Hospital refunds for sales that occur in a given fiscal year:

2002-03	7,691,674
2003-04	8,276,241
2004-05	8,905,236
2005-06	9,582,034
2006-07	10,310,268
2007-08	11,093,849

The amounts for 2003-04 and 2004-05 are the amounts that are anticipated to be backed out of individual agencies by the Office of State Budget and Management in their budget certification process.

**NOTE:** Indirect purchases are not included in these estimates, as they are not affected by the legislation.

#### **EXPENDITURES:**

The primary impact of the legislation on expenditures is the reduction in agency budgets to reflect the sales tax exemption. Under the bill the Office of Management and Budget is directed to determine the amount of sales tax each agency would have spent and reduce their funding allocation by the amount. After the first year, this process will become unnecessary. This fiscal note assumes that the Office of Management and Budget will be able to back out the sales tax numbers and that 2003-04 and 2004-05 allocations will be reduced to reflect the reduced cost of doing business.

**SOURCES OF DATA:** NC Department of Revenue, Office of State Budget and Management, and the constituent institutions of the University of North Carolina.



# **LEGISLATIVE PROPOSAL #5**

---

## **UNIFORM TAX REFUND PROCEDURE**

---

## LEGISLATIVE PROPOSAL 5:

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE  
TO THE 2003 GENERAL ASSEMBLY, 2003 SESSION

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

---

---

**SHORT TITLE:** Uniform Tax Refund Procedure.

---

---

**SPONSORS:** Sen. Hartsell, Clodfelter, Dalton, Hoyle, Kerr

---

---

**BRIEF OVERVIEW:** This proposal establishes a uniform tax refund procedure by repealing the “protest rule” and revising the statute governing refunds for overpayment of taxes to address all refund claims. Under this proposal, a taxpayer seeking a refund for any reason would be required to make a written request to the Secretary explaining why the refund is due. The Secretary would then have 90 days to review the request and issue a decision. Upon receiving notice of the Secretary's decision, a taxpayer who disagrees with the decision has 90 days to either request a hearing or file a civil action.

---

---

**FISCAL IMPACT:** No impact.

---

---

**EFFECTIVE DATE:** The proposal would become effective January 1, 2004, and apply to taxes paid on or after that date.

---

---

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

GENERAL ASSEMBLY OF NORTH CAROLINA  
SESSION 2003

H

D

BILL DRAFT 2003-SVz-1A [v.12] (12/16)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)  
1/30/2003 1:00:13 PM

Short Title: Uniform Tax Refund Procedure.

(Public)

---

Sponsors:

---

Referred to:

---

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

The General Assembly of North Carolina enacts:

**SECTION 1.** The first sentence of G.S. 105-267 is recodified as the first sentence of G.S. 105-266.1(a). The remainder of G.S. 105-267 is repealed.

**SECTION 2.** G.S. 105-266.1, as amended by Section 1 of this act, reads as rewritten:

**"§ 105-266.1. Contesting a tax; Refunds refunds of overpayment of taxes.**

(a) Contesting a tax. – No court of this State shall entertain a suit of any kind brought for the purpose of preventing the collection of any tax imposed in this Subchapter.

(a1) Request for Refund. – A taxpayer may request a refund of tax paid by the taxpayer by making a written request to the Secretary for a refund. The refund request must explain why the refund is due and must be submitted within the period of the statute of limitations established in G.S. 105-266. The Secretary must review a request for refund within 90 days after it is received and determine whether the refund is due. If the Secretary requests the taxpayer to provide additional information needed to make a determination, the time allowed for making the determination is extended until 30 days after the Secretary received the information. The Secretary must notify the taxpayer of a determination and adjust the refund, if needed, in accordance with the determination. A taxpayer who disagrees with the Secretary's determination may request a hearing under subsection (a2) of this section or bring a civil action under subsection (c) of this section.

~~If a taxpayer claims that a tax or an~~

1 ~~additional tax paid by the taxpayer was excessive or incorrect, the taxpayer may~~  
2 ~~apply to the Secretary for refund of the tax or additional tax at any time within the~~  
3 ~~period set by the statute of limitations in G.S. 105-266.~~

4 (a2) Hearing. – A taxpayer may obtain a hearing on a refund determination by  
5 filing a written request for a hearing within 90 days after notification of the  
6 determination. The Secretary shall grant a hearing on each timely request for a  
7 refund. Within 60 days after a timely request for a refund hearing has been filed and  
8 at least 10 days before the date set for the hearing, the Secretary shall notify the  
9 taxpayer in writing of the time and place at which the hearing will be conducted. The  
10 date set for the hearing shall be within 90 days after the timely request for a hearing  
11 was filed or at a later date mutually agreed upon by the taxpayer and the Secretary.  
12 The date set for the hearing may be postponed once, at the request of the taxpayer or  
13 the Secretary, for a period of up to 90 days or for a longer period mutually agreed  
14 upon by the taxpayer and the Secretary.

15 Within 90 days after conducting a hearing under this subsection, the Secretary  
16 shall make a decision on the requested refund, notify the taxpayer of the decision,  
17 and adjust the computation of the tax in accordance with the decision. ~~The Secretary~~  
18 ~~shall refund to the taxpayer in accordance with G.S. 105-266 the amount of any tax~~  
19 ~~the Secretary finds was paid incorrectly or paid in excess of the tax due.~~

20 (b) Procedure. – The rules of evidence do not apply in a hearing before the  
21 Secretary of Revenue under this section. G.S. 105-241.2, 105-241.3, and 105-241.4  
22 apply to a tax or additional tax assessed under this section. G.S. 105-266 governs a  
23 refund issued under this section.

24 (c) Civil Action. – A taxpayer may bring a civil action against the Secretary to  
25 recover the amount a taxpayer claims is an overpayment as a result of the  
26 determination denying the request for refund. The taxpayer must bring the civil  
27 action within 90 days after notification of the determination. ~~Within 90 days after~~  
28 ~~notification of the Secretary's decision with respect to a demand for refund of any tax~~  
29 ~~or additional tax under this section, an aggrieved taxpayer may, instead of petitioning~~  
30 ~~for administrative review by the Tax Review Board under G.S. 105-241.2, bring a~~  
31 ~~civil action against the Secretary for recovery of the alleged overpayment.~~ If the  
32 alleged overpayment is more than two hundred dollars (\$200.00), the taxpayer may  
33 bring the action either in the Superior Court of Wake County or in the superior court  
34 of the county in which the taxpayer resides; if the alleged overpayment is two  
35 hundred dollars (\$200.00) or less, the taxpayer may bring the action in any State  
36 court of competent jurisdiction in Wake County. If upon trial it is determined that  
37 ~~there has been an overpayment of tax or additional tax,~~ the taxpayer is entitled to a  
38 refund of tax or an additional tax paid by the taxpayer, judgment shall be rendered  
39 therefor, with interest, and the State shall refund the amount due.

40 (d) Appeal. – Either party may appeal to the appellate division from the  
41 judgment of the superior court under the rules and regulations prescribed by law for

1 appeals, except that ~~the Secretary, if he should appeal, shall not be if the Secretary~~  
2 appeals, the Secretary is not required to give any undertaking or make any deposit to  
3 secure the cost of such the appeal.

4 (e) Alternative Procedure. – Nothing in this section shall be construed to  
5 conflict with or supersede the provisions of G.S. 105-241.2, ~~and, with respect to tax~~  
6 ~~paid to the Secretary of Revenue, the rights granted by this section are in addition to~~  
7 ~~the rights provided by G.S. 105-267, 105-241.2."~~

8 **SECTION 3.** G.S. 105-113.113(a) reads as rewritten:

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

- 15 (1) The tax has been fully paid and the taxpayer has no current right  
16 under ~~G.S. 105-267~~ Article 9 of this Chapter to seek a refund.
- 17 (2) The taxpayer has been notified of the final assessment of the tax  
18 under G.S. 105-241.1 and has neither fully paid nor timely  
19 contested the tax under ~~G.S. 105-241.1 through G.S. 105-241.4 or~~  
20 ~~G.S. 105-267.~~ Article 9 of this Chapter."

21 **SECTION 4.** G.S. 105-239.1(c) reads as rewritten:

22 "(c) The provisions of G.S. 105-241.1, 105-241.2, 105-241.3, 105-241.4,  
23 ~~105-266.1 and 105-267~~ and 105-266.1 with respect to assessment procedure, demand  
24 for refund, review, and appeal ~~shall~~ apply to the liability of any transferee assessed  
25 under this section or of any property subject to the liability imposed by this section  
26 and to the assertion of a lien upon property in the hands of the transferee."

27 **SECTION 5.** G.S. 105-241.4 reads as rewritten:

28 **"§ 105-241.4. Action to recover tax paid.**

29 Within 30 days after notification of the Secretary's decision with respect to  
30 liability under this Subchapter or Subchapter V, any taxpayer aggrieved ~~thereby, by~~  
31 the decision, in lieu of petitioning for administrative review thereof by the Tax  
32 Review Board under G.S. 105-241.2, may pay the tax and bring a civil action for its  
33 recovery as provided in G.S. ~~105-267, 105-266.1.~~

34 Any taxpayer who has obtained an administrative review by the Tax Review  
35 Board as provided by G.S. 105-241.2 and who is aggrieved by the decision of the  
36 Board may, in lieu of appealing pursuant to the provisions of G.S. 105-241.3, within  
37 30 days after notification of the Board's decision with respect to liability pay the tax  
38 and bring a civil action for its recovery as provided in G.S. ~~105-267, 105-266.1.~~

39 Either party may appeal to the appellate division from the judgment of the  
40 superior court under the rules and regulations prescribed by law for appeals, except

1 that if the Secretary appeals, the Secretary is not required to give any undertaking or  
2 make any deposit to secure the cost of the appeal.

3 Any taxes, interest or penalties paid and found by the court to be in excess of  
4 those which can be properly assessed shall be ordered refunded to the taxpayer with  
5 interest from time of payment."

6 **SECTION 6.** G.S. 105-266(e) reads as rewritten:

7 "(e) Scope. —~~This section does not apply to interest required under G.S.~~  
8 ~~105-267.~~ This section applies to a refund payable to a husband and wife who filed a  
9 joint return."

10 **SECTION 7.** G.S. 105-266.1(e) reads as rewritten:

11 "(e) Nothing in this section shall be construed to conflict with or supersede the  
12 provisions of ~~G.S. 105-241.2, and, with respect to tax paid to the Secretary of~~  
13 ~~Revenue, the rights granted by this section are in addition to the rights provided by~~  
14 ~~G.S. 105-267.~~ G.S. 105-241.2."

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

16 "(15) For the recovery of taxes paid as provided in ~~G.S. 105-267 and G.S.~~  
17 105-381."

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

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

21 If the garnishee has no defense to offer or no setoff against the  
22 taxpayer, he shall, within 10 days after service of said notice,  
23 answer the same by sending to the Commissioner of Motor Vehicles  
24 by registered mail a statement to that effect, and if the amount due  
25 or belonging to the taxpayer is then due or subject to his demand, it  
26 shall be remitted to the Commissioner with said statement, but if  
27 said amount is to mature in the future, the statement shall set forth  
28 that fact and the same shall be paid to the Commissioner upon  
29 maturity, and any payment by the garnishee hereunder shall be a  
30 complete extinguishment of any liability therefor on his part to the  
31 taxpayer. If the garnishee has any defense or setoff, he shall state  
32 the same in writing under oath, and, within 10 days after service of  
33 said notice, shall send two copies of said statement to the  
34 Commissioner by registered mail; if the Commissioner admits such  
35 defense or setoff, he shall so advise the garnishee in writing within  
36 10 days after receipt of such statement and the attachment or  
37 garnishment shall thereupon be discharged to the amount required  
38 by such defense or setoff, and any amount attached or garnished  
39 hereunder which is not affected by such defense or setoff shall be  
40 remitted to the Commissioner as above provided in cases where the  
41 garnishee has no defense or setoff, and with like effect. If the

1 Commissioner shall not admit the defense or setoff, he shall set  
2 forth in writing his objections thereto and shall send a copy thereof  
3 to the garnishee within 10 days after receipt of the garnishee's  
4 statement, or within such further time as may be agreed on by the  
5 garnishee, and at the same time he shall file a copy of said notice, a  
6 copy of the garnishee's statement, and a copy of his objections  
7 thereto in the superior court of the county where the garnishee  
8 resides or does business where the issues made shall be tried as in  
9 civil actions.

10 If judgment is entered in favor of the Commissioner of Motor  
11 Vehicles by default or after hearing, the garnishee shall become  
12 liable for the taxes, interest and penalties due by the taxpayer to the  
13 extent of the amount over and above any defense or setoff of the  
14 garnishee belonging, owing, or to become due to the taxpayer, but  
15 payments shall not be required from amounts which are to become  
16 due to the taxpayer until the maturity thereof, nor shall more than  
17 ten percent (10%) of any taxpayer's salary or wages be required to  
18 be paid hereunder in any one month. The garnishee may satisfy said  
19 judgment upon paying said amount, and if he fails to do so,  
20 execution may issue as provided by law. From any judgment or  
21 order entered upon such hearing either the Commissioner of Motor  
22 Vehicles or the garnishee may appeal as provided by law. If, before  
23 or after judgment, adequate security is filed for the payment of said  
24 taxes, interest, penalties, and costs, the attachment or garnishment  
25 may be released or execution stayed pending appeal, but the final  
26 judgment shall be paid or enforced as above provided. The  
27 taxpayer's sole remedies to question his liability for said taxes,  
28 interest, and penalties shall be those provided in ~~G.S. 105-267, as~~  
29 ~~now or hereafter amended or supplemented.~~ Article 9 of Chapter  
30 105 of the General Statutes. If any third person claims any  
31 intangible attached or garnished hereunder and his lawful right  
32 thereto, or to any part thereof, is shown to the Commissioner, he  
33 shall discharge the attachment or garnishment to the extent  
34 necessary to protect such right, and if such right is asserted after the  
35 filing of said copies as aforesaid, it may be established by  
36 interpleader as now or hereafter provided by the General Statutes in  
37 cases of attachment and garnishment. In case such third party has no  
38 notice of proceedings hereunder, he shall have the right to file his  
39 petition under oath with the Commissioner at any time within 12  
40 months after said intangible is paid to him and if the Commissioner  
41 finds that such party is lawfully entitled thereto or to any part

1           thereof, he shall pay the same to such party as provided for refunds  
2           by G.S. 105-407 and if such payment is denied, said party may  
3           appeal from the determination of the Commissioner to the Superior  
4           Court of Wake County or to the superior court of the county  
5           wherein he resides or does business. The intangibles of a taxpayer  
6           shall be paid or collected hereunder only to the extent necessary to  
7           satisfy said taxes, interest, penalties, and costs. Except as hereinafter  
8           set forth, the remedy provided in this section shall not be resorted to  
9           unless a warrant for collection or execution against the taxpayer has  
10          been returned unsatisfied: Provided, however, if the Commissioner  
11          is of opinion that the only effective remedy is that herein provided,  
12          it shall not be necessary that a warrant for collection or execution  
13          shall be first returned unsatisfied, and in no case shall it be a  
14          defense to the remedy herein provided that a warrant for collection  
15          or execution has not been first returned unsatisfied: Provided,  
16          however, that no salary or wage at the rate of less than two hundred  
17          dollars (\$200.00) per month, whether paid weekly or monthly, shall  
18          be attached or garnished under the provisions of this section."

19               **SECTION 10.** This act becomes effective January 1, 2004, and applies  
20          to taxes paid on or after that date.  
21



## BILL ANALYSIS OF LEGISLATIVE PROPOSAL 5: UNIFORM TAX REFUND PROCEDURE

BY: TRINA GRIFFIN, RESEARCH DIVISION

---

**SUMMARY:** *Legislative Proposal 5 establishes a uniform tax refund procedure by repealing the "protest rule" and revising the statute governing refunds for overpayment of taxes to address all refund claims. Under this proposal, a taxpayer seeking a refund for any reason would be required to make a written request to the Secretary explaining why the refund is due. The Secretary would then have 90 days to review the request and issue a decision. Upon receiving notice of the Secretary's decision, a taxpayer who disagrees with the decision has 90 days to either request a hearing or file a civil action.*

*The proposal would become effective January 1, 2004, and apply to taxes paid on or after date.*

**CURRENT LAW:** The refund procedure for a tax paid by a taxpayer depends on the nature of the claim.<sup>1</sup> If the taxpayer is challenging the constitutionality of a tax, then the taxpayer must follow the procedure set out in G.S. 105-267, known as the "payment under protest rule." If the taxpayer claims that the tax paid was incorrect or excessive, then G.S. 105-266.1 governs the refund procedure. Under both statutes, the taxpayer is required to apply to the Secretary in writing for a refund. Under G.S. 105-267, the refund request must be made within three years after payment.<sup>2</sup> Under G.S. 105-266.1, the refund request must be made within three years after the date for filing of the return or within 6 months after payment of the tax, whichever is later.<sup>3</sup> At this stage, the procedure varies as follows:

*Payment under protest (G.S. 105-267).* – Once the refund request has been made, the Secretary has 90 days to issue a decision and refund the tax in accordance with the decision. If the tax is not refunded within 90 days, the taxpayer may file a civil

---

<sup>1</sup> This summary addresses the two main refund statutes, G.S. 105-266.1 and G.S. 105-267, which have varying statutes of limitation periods for filing suit among their procedural differences. G.S. 105-241.4 is another statute that authorizes a taxpayer to recover a tax paid by filing suit and has yet another statute of limitations period. This statute may be invoked after the Secretary has conducted a hearing and issued a decision on a proposed assessment. The hearing is distinguished from the hearing authorized by G.S. 105-266.1 in that the taxpayer is not required to pay the tax prior to the hearing. Within 30 days after the Secretary's decision is issued, the taxpayer may pay the tax and file a civil action. The total timeframe from the notice of the proposed assessment to the filing of a lawsuit under this statute is less than one year.

<sup>2</sup> The protest period for taxes paid on alcoholic beverages, tobacco products, and controlled substances is 30 days after payment.

<sup>3</sup> 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.

action at any time within three years after the expiration of the 90-day period allowed for making the refund. Thus, a taxpayer has a maximum of 6 years and 90 days from payment of the tax to bring a civil action. If upon trial it is determined that all or part of the tax was levied for an illegal or unauthorized purpose, judgment shall be rendered for the taxpayer, and the amount of the judgment shall be refunded by the State.

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

1. Petition for administrative review before the Tax Review Board under G.S. 105-241.2<sup>4</sup>; or
2. Bring a civil action against the Secretary for recovery of the alleged overpayment.<sup>5</sup>

**BILL ANALYSIS:** Section 1 of the proposal repeals G.S. 105-267, with the exception of the first sentence, which is recodified as the first sentence of G.S. 105-266.1. The recodification of the first sentence preserves the case law upholding the constitutionality of the statutory requirement that a taxpayer pay the tax prior to challenging the legality of the tax in court.

Section 2 of the proposal sets out the procedure for requesting a refund for a tax paid regardless of the nature of the claim. In order to obtain a refund, a taxpayer must first make a written request to the Secretary explaining why the refund is due. The request must be made within three years after the date for filing of the return or within 6 months after payment of the tax, whichever is later. Within 90 days, the Secretary must review the request, determine whether a refund is due, notify the taxpayer of the decision, and adjust the refund, if needed, in accordance with the decision. A taxpayer who disagrees with the Secretary’s determination may, within 90 days after notification, request a hearing or bring a civil action.

The main differences between the current law and the bill draft with regard to refunds based on the unconstitutionality of a tax are as follows:

---

<sup>4</sup> Either party may appeal a decision of the Tax Review Board to superior court, then to the North Carolina Court of Appeals, and then to the North Carolina Supreme Court.

<sup>5</sup> Either party may appeal to the appellate division from the judgment of the superior court.

Current Law	Bill Draft
<ul style="list-style-type: none"> <li>• Refund request must be made within 3 years after payment.</li> <li>• Civil action may be brought within 3 years after the 90-day period allowed for making a refund.</li> <li>• The suit may be brought in the Superior Court of Wake County or in the county in which the taxpayer resides.</li> </ul>	<ul style="list-style-type: none"> <li>• Refund request must be made within 3 years after the date for filing of the return or within 6 months after payment of the tax, whichever is later.</li> <li>• Civil action may be brought within 90 days after notification of the refund decision.</li> <li>• The suit may be brought in either the Superior Court of Wake County or in the county in which the taxpayer resides if the amount of the refund demand is more than \$200. If the refund demand is less than \$200, the suit may be brought in any State court of competent jurisdiction in Wake County.</li> </ul>

The main differences between the current law and the bill draft with regard to refunds based on payment of an incorrect or excessive tax are:

Current Law	Bill Draft
<ul style="list-style-type: none"> <li>• Secretary is required to schedule a hearing on each refund request. The hearing must be scheduled within 90 days of the refund request.</li> <li>• The Secretary must issue a decision within 90 days of the hearing.</li> <li>• Within 90 days after notification of the Secretary's decision, the taxpayer may either petition for administrative review or file a civil action.</li> </ul>	<ul style="list-style-type: none"> <li>• No hearing required to be scheduled upon receipt of refund request.</li> <li>• The Secretary must issue decision within 90 days of receipt of refund request.</li> <li>• Within 90 days after notification of the Secretary's decision, the taxpayer may either request a hearing before the Secretary or file a civil action.</li> </ul>

Sections 3 through 9 of the bill are technical and conforming changes.

## BACKGROUND:

### LEGISLATIVE HISTORY OF THE STATUTE OF LIMITATIONS PERIOD

For well over 50 years, the statute of limitations in North Carolina for requesting a refund under G.S. 105-267 was 30 days after payment of the tax.<sup>6</sup> Then in 1996, the General Assembly extended the period to one year for all taxes except for the taxes on alcoholic beverages, tobacco products, and controlled substances, which remained at 30 days. In 1999, the General Assembly extended the protest period from one to three years.<sup>7</sup> Under current law, a person may demand a refund in writing at any time within three years after making payment. If the tax is not refunded within 90 days, the taxpayer may file suit against the Secretary of the Department of Revenue at any time within three years after the expiration of the 90-day period.

### **Judicial Interpretation of Protest Rule**

The protest rule has proven problematic for both the Department and tax practitioners. The statute's vagueness has raised issues with regard to what constitutes a valid protest, whether all similarly situated taxpayers must file a protest, and when a protest should be filed to best serve the taxpayer. The North Carolina Supreme Court further muddled the waters in 1998 when it held in Bailey II<sup>8</sup> that all taxpayers who wrongfully had their benefit contracts impaired by the State, not just those who complied with G.S. 105-267, were entitled to refunds. The Court found that G.S. 105-267 was simply a procedural requirement designed to give the State notice of potential liabilities and allow it to budget accordingly. In addition to finding that the State did have sufficient notice of its potential liability for all taxpayers involved, the Court also seemed to be influenced by the fact that North Carolina does not provide taxpayers with any predeprivation procedures for determining the legality of a tax. Thus, after Bailey II, it appears that if a taxpayer pays under protest and initiates litigation, then all other similarly situated taxpayers stand to benefit from the protest if the litigation succeeds.

The broad fiscal implications of the Bailey II Court's statutory interpretation have already been felt in a subsequent lawsuit against the State. In Smith v. State, 349 N.C. 332, 341, 507 S.E.2d 28, 33 (1998), the North Carolina Supreme Court held that the State owed hundreds of millions of dollars in additional refunds to all taxpayers who paid unconstitutional intangibles taxes, including those taxpayers who did not

---

<sup>6</sup> Most states that utilize a protest rule have a statute of limitations longer than 30 days.

<sup>7</sup> Under current law, the statute of limitations for requesting a refund for taxes paid on alcoholic beverages, tobacco products, and controlled substances is still 30 days.

<sup>8</sup> In Bailey v. State of North Carolina, 348 N.C. 130, 500 S.E.2d 54 (1998), the Court found unconstitutional legislation that placed a cap on a tax exemption for state and local government employees' retirement benefits.

protest payment. However, the Court made clear that its decision was controlled, not by an interpretation of G.S. 105-267, but rather by the constitutional uniformity requirement.

# **LEGISLATIVE PROPOSAL #6**

---

## **REVENUE ADMINISTRATIVE CHANGES**

---

## LEGISLATIVE PROPOSAL 6:

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE  
TO THE 2003 GENERAL ASSEMBLY, 2003 SESSION

**AN ACT TO MODIFY THE DIVIDENDS 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, AND TO MAKE VARIOUS  
ADMINISTRATIVE CHANGES IN THE TAX LAWS.**

---

**SHORT TITLE:** Revenue Administrative Changes.

---

**SPONSORS:** **Rep. Allen,** Hill, Holliman, Luebke, Wainwright  
**Sen. Kerr,** Clodfelter, Dalton, Hartsell, Hoyle

---

**BRIEF OVERVIEW:** This proposal makes the following changes with regard to the administration of the tax laws:

- 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.
- It amends the reporting requirements regarding sales of seized property by the Secretary of Revenue to avoid duplicative filing of reports.
- It extends until October 1, 2005 the Department of Revenue's authority to continue using outside collection agencies for the collection of in-state tax debts.
- It revises the secrecy provision regarding the disclosure of tax information to reflect the transfer of the Division of Motor Vehicles to the Division of the State Highway Patrol of the Department of Crime Control and Public Safety.

- 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.
- It simplifies the process for making the 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.
- It clarifies that the \$20 filing fee for annual reports is nonrefundable.

---

---

*FISCAL IMPACT:* Insignificant.

---

---

*EFFECTIVE DATE:* See the explanation.

---

---

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



**GENERAL ASSEMBLY OF NORTH CAROLINA  
SESSION 2003**

**H**

**D**

**BILL DRAFT 2003-SVxfz-2 [v.11] (01/13)**

**(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)  
1/30/2003 12:34:56 PM**

Short Title: Revenue Administrative Changes.

(Public)

---

Sponsors:

---

Referred to:

---

1 A BILL TO BE ENTITLED  
2 AN ACT TO MODIFY THE DIVIDENDS RECEIVED DEDUCTION FOR  
3 REGULATED INVESTMENT COMPANIES AND REAL ESTATE  
4 INVESTMENT TRUSTS TO ENSURE THAT ALL DIVIDENDS ARE  
5 TREATED UNIFORMLY, TO EXTEND FOR TWO YEARS THE  
6 DEPARTMENT OF REVENUE'S AUTHORITY TO OUTSOURCE THE  
7 COLLECTION OF IN-STATE TAX DEBTS, AND TO MAKE VARIOUS  
8 ADMINISTRATIVE CHANGES IN THE TAX LAWS.

9 The General Assembly of North Carolina enacts:

10 **MODIFY DIVIDENDS RECEIVED DEDUCTION FOR RICs AND REITs.**

11 **SECTION 1.** G.S. 105-130.7 and G.S. 105-130.5(b)(3) are repealed.

12 **SECTION 2.** G.S. 105-130.4(c) reads as rewritten:

13 "(c) Rents and royalties from real or tangible personal property, gains and  
14 losses, interest, ~~dividends less the portion deductible under G.S. 105-130.7,~~ dividends,  
15 patent and copyright royalties and other kinds of income, to the extent that they  
16 constitute nonbusiness income, less related expenses shall be allocated as provided in  
17 subsections (d) through (h) of this section."

18 **SECTION 3.** G.S. 105-130.4(f) reads as rewritten:

19 "(f) Interest and net dividends are allocable to this State if the corporation's  
20 commercial domicile is in this State. For purposes of this section, the term "net  
21 dividends" means gross dividend income received less related ~~expenses and less that~~  
22 ~~portion of the dividends deductible under G.S. 105-130.7.~~ expenses."

23 **AVOID DUPLICATIVE REPORTING REQUIREMENTS REGARDING**  
24 **SALES OF SEIZED PROPERTY.**

1           **SECTION 4.** G.S. 105-242(a)(2) reads as rewritten:

2           (2)    The Secretary may issue a warrant or order under the Secretary's  
3                   hand and seal to any revenue officer or other employee of the  
4                   Department of Revenue charged with the duty to collect taxes,  
5                   commanding the officer or employee to levy upon and sell the  
6                   taxpayer's personal property, including that described in G.S.  
7                   105-366(d), found within the State for the payment of the tax,  
8                   including penalties and interest. Except as otherwise provided in  
9                   this subdivision, the levy upon the sale of personal property shall be  
10                  governed by the laws regulating levy and sale under execution. The  
11                  person to whom the warrant is directed shall proceed to levy upon  
12                  and sell the personal property subject to levy in the same manner  
13                  and with the same powers and authority normally exercised by  
14                  sheriffs in levying upon and selling personal property under  
15                  execution, except that the property may be sold in any county, in the  
16                  discretion of the Secretary. In addition to the notice of sale required  
17                  by the laws governing sale of property levied upon under execution,  
18                  the Secretary may advertise the sale in any reasonable manner and  
19                  for any reasonable period of time to produce an adequate bid for the  
20                  property. Levy and sale fees, plus actual advertising costs, shall be  
21                  added to and collected in the same manner as taxes. The Secretary is  
22                  not required to file a report of sale with the clerk of superior court,  
23                  as required by the laws governing sale of property levied upon  
24                  under execution, if the sale is otherwise publicly reported."

25           **EXTEND AUTHORITY TO CONTINUE USING OUTSIDE COLLECTION**  
26           **AGENCIES.**

27           **SECTION 5.** Section 9 of S.L. 2001-380 reads as rewritten:

28           "SECTION 9. Section 3 of this act becomes effective November 1, 2001.  
29           Section 6 of this act is effective on and after July 1, 2001. Section 8 of this act  
30           becomes effective ~~October 1, 2003.~~ October 1, 2005. The remainder of this act is  
31           effective when it becomes law and applies to tax debts that remain unpaid on or after  
32           that date."

33           **REVISE SECRECY PROVISION TO REFLECT TRANSFER OF DMV**  
34           **ENFORCEMENT TO THE DIVISION OF THE STATE HIGHWAY**  
35           **PATROL.**

36           **SECTION 6.** G.S. 105-259(b)(7) reads as rewritten:

37           "(7)    To exchange information with the ~~Division of Motor Vehicles of~~  
38                   ~~the Department of Transportation~~ Division of the State Highway  
39                   Patrol of the Department of Crime Control and Public Safety or the  
40                   International Fuel Tax Association, Inc., when the information is  
41                   needed to fulfill a duty imposed on the Department of Revenue or

1                   the ~~Division of Motor Vehicles~~ Division of the State Highway  
2                   Patrol of the Department of Crime Control and Public Safety."

3     **BASE LOCAL SALES TAX DISTRIBUTIONS ON TAXPAYER DATA.**

4             **SECTION 7.** G.S. 105-472(a) reads as rewritten:

5             "(a) County Allocation. – The Secretary shall, on a monthly basis, allocate to  
6 each taxing county for which the Secretary collects the tax the net proceeds of the tax  
7 collected in that county under this Article. For the purpose of this section, "net  
8 proceeds" means the gross proceeds of the tax collected in each county under this  
9 Article less taxes refunded, the cost to the State of collecting and administering the  
10 tax in the county as determined by the Secretary, and other deductions that may be  
11 charged to the county. If the Secretary collects local sales or use taxes in a month and  
12 the taxes cannot be identified as being attributable to a particular taxing county, the  
13 Secretary shall allocate the taxes among the taxing counties in proportion to the  
14 amount of taxes collected in each county under this Article during that month and  
15 shall include them in the monthly distribution. Amounts collected by electronic funds  
16 transfer payments are included in the distribution for the month in which the return  
17 that applies to the payment is due."

18     **SIMPLIFY PROCEDURE FOR HOLD HARMLESS CALCULATION.**

19             **SECTION 8.** G.S. 105-521(b) reads as rewritten:

20             "(b) Distributions. – On or before May 1 of each year, the Department of  
21 Revenue and the Fiscal Research Division of the General Assembly must each  
22 submit to the Secretary and to the General Assembly a final projection of the  
23 estimated amount that all local governments would be expected to receive during the  
24 upcoming fiscal year under G.S. 105-520 if every county levied the tax under this  
25 Article for the fiscal year. If the Secretary does not use the lower of the two final  
26 projections to make the calculation required by this subsection, the Secretary must  
27 report the reasons for this decision to the Joint Legislative Commission on  
28 Governmental Operations within 60 days after receiving the projections.

29             ~~On or before September 15, 2003, and each September 15 thereafter,~~ 15 of each  
30 year, the Secretary must multiply each local government's local sales tax share by the  
31 estimated amount that all local governments would be expected to receive during the  
32 current fiscal year under G.S. 105-520 if every county levied the tax under this  
33 Article for the year. If the resulting amount is less than one hundred percent (100%)  
34 of the local government's repealed reimbursement amount, the Secretary must pay the  
35 local government the difference, but not less than one hundred dollars (\$100.00).

36             ~~On or before May 1, 2003, and each May 1 thereafter, the Office of State Budget~~  
37 ~~and Management and the Fiscal Research Division of the General Assembly must~~  
38 ~~each submit to the Secretary and to the General Assembly a final projection of the~~  
39 ~~estimated amount that all local governments would be expected to receive during the~~  
40 ~~upcoming fiscal year under G.S. 105-520 if every county levied the tax under this~~  
41 ~~Article for the fiscal year. If the Secretary does not use the lower of the two final~~

1 ~~projections to make the calculation required by this subsection, the Secretary must~~  
2 ~~report the reasons for this decision to the Joint Legislative Commission on~~  
3 ~~Governmental Operations within 60 days after receiving the projections."~~

4 **CLARIFY THAT THE FILING FEE FOR AN ANNUAL REPORT IS**  
5 **NONREFUNDABLE.**

6 **SECTION 9.** G.S. 55-1-22 is amended by adding a new subsection to  
7 read:

8 "(d) The fee for the annual report in subdivision (23) of this section is  
9 nonrefundable."

10 **EFFECTIVE DATE.**

11 **SECTION 10.** Sections 1, 2, and 3 are effective for taxable years  
12 beginning on or after January 1, 2003. Section 7 becomes effective July 1, 2003.  
13 The remainder of this act is effective when it becomes law.

## BILL ANALYSIS OF LEGISLATIVE PROPOSAL 6: REVENUE ADMINISTRATIVE CHANGES

BY: TRINA GRIFFIN, RESEARCH DIVISION

---

**SUMMARY:** *Legislative Proposal 6 makes the following changes with regard to the administration of the tax laws:*

- *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.*
- *It amends the reporting requirements regarding sales of seized property by the Secretary of Revenue to avoid duplicative filing of reports.*
- *It extends until October 1, 2005 the Department of Revenue's authority to continue using outside collection agencies for the collection of in-state tax debts.*
- *It revises the secrecy provision regarding the disclosure of tax information to reflect the transfer of the Division of Motor Vehicles to the Division of the State Highway Patrol of the Department of Crime Control and Public Safety.*
- *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.*
- *It simplifies the process for making the 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.*
- *It clarifies that the \$20 filing fee for annual reports is nonrefundable.*

### SECTION-BY-SECTION BILL ANALYSIS:

#### Sections 1, 2, and 3: Modify dividends received deduction for RICs and REITs

**CURRENT LAW:** G.S. 105-130.7(a) provides that a corporation may deduct the proportionate part of dividends received by it from a regulated investment company (RIC) or a real estate investment trust (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 are deductible only to the extent that income received by that corporation from a RIC or a REIT is taxable by North Carolina.

**BILL ANALYSIS:** Section 1 of the proposal repeals G.S. 105-130.7. The repeal of G.S. 105-130.5(b)(3) and the changes in Sections 2 and 3 of the proposal are conforming changes.

Dividends received from a RIC qualify for the federal dividends received deduction. Therefore, the repeal of G.S. 105-130.7(a) is a technical change with regard to RICs because dividends received from those companies will continue to receive the same tax treatment under the proposal as under current law. 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 current law, dividends from REITs are taxed more favorably for State tax purposes than under federal law. The repeal of G.S. 105-130.7 would ensure that the State category of dividends with respect to REITs is the same as under federal law.

#### **FEDERAL LAW:**

Dividends received deduction.<sup>1</sup> – The dividends received deduction is meant to reduce the negative effects of the double tax on C corporation profits distributed to corporation shareholders as dividends. 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% of the corporations are "affiliated" under the Code.

Regulated investment companies (RICs). – Certain investment companies, including mutual funds, may elect to be taxed as regulated investment companies. There are several conditions that must be satisfied to qualify for the election, of which the salient features are that ninety percent of gross income must be derived from dividends, interest, and gains on the sale of stock or securities, and that the corporation's investments must be diversified as prescribed by Section 851 of the 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. Dividends received from RICs are eligible for the federal deduction, subject to additional limitations.<sup>2</sup>

Real estate investment trusts (REITs). – A real estate investment trust is a corporation or trust that uses the pooled capital of many investors to purchase and manage income property and/or mortgage loans. REITs are traded on major exchanges just like stocks. They are also granted special tax considerations. They pay yields in the

---

<sup>1</sup> 26 U.S.C. 243.

<sup>2</sup> Capital gain dividends received from a regulated investment company do not qualify for the deduction.

form of dividends. However, REITs are not eligible for the federal dividends received deduction.

**BACKGROUND:** In 2001, the General Assembly repealed G.S. 105-130.7(b) and G.S. 105-130.5(a)(7), which provided corporations with an income tax deduction for dividends received by their subsidiaries. As a result of the repeal, North Carolina law now piggybacks the federal law with regard to the dividends received deduction for subsidiary dividends. Adopting the federal approach simplifies 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 of this proposal would be consistent with this approach.

#### **Section 4: Avoid duplicative reporting requirements regarding sales of seized property**

**CURRENT LAW:** If any tax levied by the State and payable to the Secretary of Revenue has not been paid within 30 days after the taxpayer was given a notice of final assessment of the tax, the Secretary is authorized to collect the tax through the levy upon and sale of real or personal property of the taxpayer. The Secretary may either direct the sheriff to levy upon and sell property, or it may levy upon the property itself through one of the Department's employees.

Most personal property seized by the Department of Revenue is for the payment of unauthorized substance taxes. When the Department levies upon the property itself 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 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 conducting 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. Since the Department is subject to the same laws governing execution sales, it has construed this provision to mean that the Department must file a report of all sales of seized property with the clerk of superior court.

**BILL ANALYSIS:** Section 4 of the proposal amends G.S. 105-242 such 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.

Since the Department of Administration makes a report of all property sold through the surplus property sales, the Department of Revenue does not see a need to file a report of sale with the clerk of court as well. 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.

#### **Section 5: Extend authority to use outside collection agencies**

**CURRENT LAW:** The Department of Revenue has permanent authority to outsource out-of-state tax debts and temporary authority to outsource in-state tax debts. This temporary authority is scheduled to expire on October 1, 2003.

**BILL ANALYSIS:** Section 5 of the proposal extends the authority of the Department of Revenue to outsource in-state tax debts for an additional two years.

**BACKGROUND:** 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<sup>3</sup> 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 General Assembly enacted legislation that substituted a broader debt collection program for the pilot program. Under this program, 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.

#### **Section 6: Revise secrecy provision to reflect transfer of DMV to the State Highway Patrol**

**CURRENT LAW:** Under 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 unless authorized to do by statute. There are several exceptions to this rule, one of which is that tax information may be disclosed for the purpose of exchanging 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 of the Division of Motor Vehicles.

---

<sup>3</sup> 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.



**BILL ANALYSIS:** Section 6 of the proposal 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" to reflect departmental changes made last year.

**BACKGROUND:** In 2002, the General Assembly enacted legislation<sup>4</sup> that transferred 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 to the Department of Crime Control and Public Safety, effective January 1, 2003. Consequently, the reference to the "Division of Motor Vehicles of the Department of Transportation" in G.S. 105-259(b)(7) needs to be amended to reflect this transfer to preserve the secrecy provision currently in place. Specifically, the State Highway Patrol will be performing the functions of the prior DMV Enforcement Section.

#### **Section 7: Base local sales tax distributions on taxpayer data**

**CURRENT LAW:** Pursuant to G.S. 105-472, the Secretary of Revenue makes quarterly distributions of local sales and use tax proceeds to cities and counties. In 2001, the General Assembly accelerated the payment of local sales and use tax revenues by requiring that the distribution be made on a monthly basis, effective beginning July 1, 2003.

In addition, 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 monthly basis. Sales and use tax revenues received between the 1st and 15th of the month must be paid by the 25<sup>th</sup> of the same month, while sales and use tax revenues from the remainder of the month must be paid by the 10<sup>th</sup> of the next month. The return for the semimonthly period is due 10 days later, on the 20<sup>th</sup> of the month. Consequently, there is no return accompanying the revenues received for the first half of each month to indicate where the funds should be distributed.

**BILL ANALYSIS:** Section 7 of the proposal 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. Since semimonthly taxpayers are required to pay by electronic funds transfer, this amendment will ensure that the Department of Revenue is distributing local sales and use tax proceeds based on known information obtained from the semimonthly return rather than a speculative estimate.

---

<sup>4</sup> S.L. 2002-190 (HB 314), as amended by S.L. 2002-159, Sec. 31.5 (SB 1217, Sec. 31.5).

### **Section 8: Simplify the procedure for hold harmless calculation**

**CURRENT LAW:** G.S. 105-521(b) directs 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 are 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<sup>5</sup>, if any, based on the projections and 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.

**BILL ANALYSIS:** Section 8 of the proposal would require the Department of Revenue, rather than the OSBM, to project the estimated amount that all local governments would be expected to receive during the upcoming fiscal year from levying the third one-half cent local sales and use tax, assuming that every county levied the tax. From a practical standpoint, the data needed to make the projections are housed within the Department of Revenue. By making this change, it simplifies the process by eliminating the need for the OSBM to first obtain the data from Revenue and then make the necessary projection. Section 8 also makes a technical change by reversing the two paragraphs in G.S. 105-521(b) so that the statutory requirements appear chronologically.

**BACKGROUND:** In 2001, the General Assembly authorized all counties of the State to levy a third one-half cent sales tax.<sup>6</sup> In that same legislation, local governments were also provided with an annual hold harmless distribution from the State's General Fund to ensure that none of them would lose money when the local government reimbursements are repealed. The hold harmless distribution provides that if a county or city's estimated proceeds from the third half-cent tax would be less than 100% of the amount it would have gotten under the repealed reimbursements, it will receive a reimbursement for the difference. If a county or city's estimated gain from the third half-cent tax exceeds 100% of its repealed reimbursements 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.

---

<sup>5</sup> The hold harmless distribution amount is obtained by multiplying the each local government's sales tax share by the estimated amount that all local government are expected to receive from levying the third one-half cent local sales and use tax; if the amount is less than 100% of the local government's repealed reimbursement amount, the Secretary must pay the local government the difference, but not less than \$100.00.

<sup>6</sup> To date, nearly 90 counties have adopted the local option third one-half cent sales tax authorized by Section 34.14 of S.L. 2001-424.

### **Section 9: Clarify that the filing fee for an annual report is nonrefundable**

**CURRENT LAW:** G.S. 55-1-22 sets out the fees for filing certain documents with the Secretary of State, including documents such as 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<sup>7</sup> 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. 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 the 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.

**BILL ANALYSIS:** Section 9 of the proposal amends G.S. 55-1-22 by adding a new subsection stating that the annual report fee of \$20.00 is nonrefundable. The purpose of this change is to codify the Department of Revenue's existing policy that annual report fees are not refundable.

**BACKGROUND:** 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 deposited. The Department of Revenue's policy with regard to the annual report is that the fee is nonrefundable.

### **Section 10: Effective date**

The repeal of the dividends received deduction is effective for taxable years beginning on or after January 1, 2003. The section regarding the local sales tax distribution is effective July 1, 2003. The remainder of the act is effective when it becomes law.

---

<sup>7</sup> Nonprofit corporations are exempt from this requirement and insurance companies are required to deliver their annual reports to the Secretary of State.

# **LEGISLATIVE PROPOSAL #7**

---

## **REVENUE LAWS TECHNICAL CHANGES**

---

## LEGISLATIVE PROPOSAL 7:

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE  
TO THE 2003 GENERAL ASSEMBLY, 2003 SESSION

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

---

---

**SHORT TITLE:** Revenue Laws Technical Changes.

---

---

**SPONSORS:** **Rep. Holliman**, Allen, Hill, Luebke, Wainwright  
**Sen. Hartsell**, Clodfelter, Dalton, Hoyle, Kerr

---

---

**BRIEF OVERVIEW:** The proposal makes technical and clarifying changes to the revenue laws and related statutes.

---

---

**FISCAL IMPACT:** No impact.

---

---

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

---

---

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

GENERAL ASSEMBLY OF NORTH CAROLINA  
SESSION 2003

S

D

BILL DRAFT 2003-LCx-2 [v.14] (11/12)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)  
1/30/2003 11:59:03 AM

Short Title: Revenue Laws Technical Changes.

(Public)

Sponsors:

Referred to:

A BILL TO BE ENTITLED  
AN ACT TO MAKE TECHNICAL AND CLARIFYING CHANGES TO THE  
REVENUE LAWS AND RELATED STATUTES.

The General Assembly of North Carolina enacts:

**SECTION 1.** Section 10 of S.L. 2002-87 reads as rewritten:

"**SECTION 10.** Section 9 of this act is effective on and after January 1, 2002, and applies to the estates of decedents dying on or after that ~~date~~, except that if the amendments made by Section 9 would create an increase in tax for a decedent dying before August 22, 2002, then the tax may be calculated under the prior law. The remainder of this act is effective when it becomes law. Section 2 of this act applies to credits for buildings ~~that are awarded a federal credit allocation before January 1, 2003, and~~ for which a federal tax credit is first claimed for a taxable year beginning on or after January 1, 2002."

**SECTION 2.** S.L. 2002-172 is reenacted.

**SECTION 3.** G.S. 105-129.40 reads as rewritten:

**"§ 105-129.40. (See Editor's note for repeal) Definitions applicable to Article.** Scope and definitions.

(a) Scope. – G.S. 105-129.41 applies to buildings that are awarded a federal credit allocation before January 1, 2003. G.S. 105-129.42 applies to buildings that are awarded a federal credit allocation on or after January 1, 2003.

(b) Definitions. – The definitions in section 42 of the Code and the following definitions apply in this Article:

(1) Housing Finance Agency. – The North Carolina Housing Finance Agency established in G.S. 122A-4.

(2) ~~Pass-Through Entity-entity.~~ – Defined in G.S. ~~105-129.35-105-228.90.~~"

**SECTION 4. (a)** G.S. 105-163.010(7) reads as rewritten:

"(7) ~~Pass-through entity.~~ – Defined in G.S. 105-228.90. ~~An entity or business, including a limited partnership, a general partnership, a joint venture, a Subchapter S Corporation, or a limited liability company, all of which is treated as owned by individuals or other entities under the federal tax laws, in which the owners report their share of the income, losses, and credits from the entity or business on their income tax returns filed with this State. For the purpose of this Part, an owner of a pass-through entity is an individual or entity who is treated as an owner under the federal tax laws."~~

**SECTION 4.(b)** G.S. 105-163.1(9) reads as rewritten:

"(9) ~~Pass-through entity.~~ – Defined in G.S. ~~105-163.010- G.S. 105-228.90.~~"

**SECTION 4.(c)** G.S. 105-129.35(c) reads as rewritten:

"(c) Definitions. – The following definitions apply in this section:

(1) Certified historic structure. – Defined in section 47 of the Code.

(2) ~~Pass-through entity.~~ – Defined in G.S. 105-228.90. ~~An entity or business, including a limited partnership, a general partnership, a joint venture, a Subchapter S Corporation, or a limited liability company, all of which is treated as owned by individuals or other entities under the federal tax laws, in which the owners report their share of the income, losses, and credits from the entity or business on their income tax returns filed with this State. For the purpose of this section, an owner of a pass through entity is an individual or entity who is treated as an owner under the federal tax laws.~~

(3) Qualified rehabilitation expenditures. – Defined in section 47 of the Code."

**SECTION 4.(d)** G.S. 105-228.90(b) is amended by adding a new subdivision to read:

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

...

(4d) Pass-through entity. – An entity or business, including a limited partnership, a general partnership, a joint venture, a Subchapter S Corporation, or a limited liability company, all of which is treated as owned by individuals or other entities under the federal tax laws, in which the owners report their share of the income, losses, and credits from the entity or business on their income tax returns filed with this State. For the purpose of this section, an owner of a

pass-through entity is an individual or entity who is treated as an owner under the federal tax laws."

**SECTION 5.(a)** G.S. 105-130.4(a)(1) reads as rewritten:

"(1) ~~'Business—'~~'Apportionable income' means all income that is apportionable under the United States Constitution."

**SECTION 5.(b)** G.S. 105-130.4(a)(5) reads as rewritten:

"(5) ~~'Nonbusiness—'~~'Nonapportionable income' means all income other than ~~business-~~apportionable income."

**SECTION 5.(c)** G.S. 105-130.4(c) reads as rewritten:

"(c) Rents and royalties from real or tangible personal property, gains and losses, interest, dividends less the portion deductible under G.S. 105-130.7, patent and copyright royalties and other kinds of income, to the extent that they constitute ~~nonbusiness-nonapportionable~~ income, less related expenses shall be allocated as provided in subsections (d) through (h) of this section."

**SECTION 5.(d)** G.S. 105-130.4(i) reads as rewritten:

"(i) All ~~business-~~apportionable income of corporations other than public utilities and excluded corporations shall be apportioned to this State by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus twice the sales factor, and the denominator of which is four. Provided, that where the sales factor does not exist, the denominator of the fraction shall be the number of existing factors and where the sales factor exists but the payroll factor or the property factor does not exist, the denominator of the fraction shall be the number of existing factors plus one."

**SECTION 5.(e)** G.S. 105-130.4(j)(2) reads as rewritten:

"(2) Property owned by the corporation is valued at its original cost. Property rented by the corporation is valued at eight times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the corporation less any annual rental rate received by the corporation from subrentals except that subrentals shall not be deducted when they constitute ~~business-~~apportionable income. Any property under construction and any property the income from which constitutes ~~nonbusiness-nonapportionable~~ income shall be excluded in the computation of the property factor.

**SECTION 5.(f)** G.S. 105-130.4(k)(1) reads as rewritten:

"(k) (1) The payroll factor is a fraction, the numerator of which is the total amount paid in this State during the income year by the corporation as compensation, and the denominator of which is the total compensation paid everywhere during the income year. All compensation paid to general executive officers and all compensation paid in connection with ~~nonbusiness~~ nonapportionable income shall be excluded in computing the



1 payroll factor. General executive officers shall include the chairman  
2 of the board, president, vice-presidents, secretary, treasurer,  
3 comptroller, and any other officers serving in similar capacities."

4 **SECTION 5.(g)** G.S. 105-130.4(l)(1) reads as rewritten:

- 5 (l) (1) The sales factor is a fraction, the numerator of which is the total  
6 sales of the corporation in this State during the income year, and the  
7 denominator of which is the total sales of the corporation  
8 everywhere during the income year. Notwithstanding any other  
9 provision under this Part, the receipts from any casual sale of  
10 property shall be excluded from both the numerator and the  
11 denominator of the sales factor. Where a corporation is not taxable  
12 in another state on its ~~business-apportionable~~ income but is taxable  
13 in another state only because of ~~nonbusiness-nonapportionable~~  
14 income, all sales shall be treated as having been made in this State."

15 **SECTION 5.(h)** G.S. 105-130.4(m) through (s) read as rewritten:

16 "(m) All ~~business-apportionable~~ income of a railroad company shall be  
17 apportioned to this State by multiplying the income by a fraction, the numerator of  
18 which is the "railway operating revenue" from business done within this State and the  
19 denominator of which is the "total railway operating revenue" from all business done  
20 by the company as shown by its records kept in accordance with the standard  
21 classification of accounts prescribed by the Interstate Commerce Commission.

22 "Railway operating revenue" from business done within this State shall mean  
23 "railway operating revenue" from business wholly within this State, plus the equal  
24 mileage proportion within this State of each item of "railway operating revenue"  
25 received from the interstate business of the company. "Equal mileage proportion"  
26 shall mean the proportion which the distance of movement of property and  
27 passengers over lines in this State bears to the total distance of movement of property  
28 and passengers over lines of the company receiving such revenue. "Interstate  
29 business" shall mean "railway operating revenue" from the interstate transportation of  
30 persons or property into, out of, or through this State. If the Secretary of Revenue  
31 ~~shall find, finds,~~ with respect to any particular company, that its accounting records  
32 are not kept so as to reflect with exact accuracy such division of revenue by State  
33 lines as to each transaction involving interstate revenue, the Secretary of Revenue  
34 may adopt such regulations, based upon averages, as will approximate with  
35 reasonable accuracy the proportion of interstate revenue actually earned upon lines in  
36 this State. Provided, that where a railroad is being operated by a partnership which is  
37 treated as a corporation for income tax purposes and pays a net income tax to this  
38 State, or if located in another state would be so treated and so pay as if located in this  
39 State, each partner's share of the net profits shall be considered as dividends paid by a  
40 corporation for purposes of this Part and shall be so treated for inclusion in gross  
41 income, deductibility, and separate allocation of dividend income.

1 (n) All ~~business~~-apportionable income of a telephone company shall be  
2 apportioned to this State by multiplying the income by a fraction, the numerator of  
3 which is gross operating revenue from local service in this State plus gross operating  
4 revenue from toll services performed wholly within this State plus the proportion of  
5 revenue from interstate toll services attributable to this State as shown by the records  
6 of the company plus the gross operating revenue in North Carolina from other service  
7 less the uncollectible revenue in this State, and the denominator of which is the total  
8 gross operating revenue from all business done by the company everywhere less total  
9 uncollectible revenue. Provided, that where a telephone company is required to keep  
10 its records in accordance with the standard classification of accounts prescribed by  
11 the Federal Communications Commission the amounts in such accounts shall be used  
12 in computing the apportionment fraction as provided in this subsection.

13 (o) All ~~business~~-apportionable income of a motor carrier of property shall be  
14 apportioned by multiplying the income by a fraction, the numerator of which is the  
15 number of vehicle miles in this State and the denominator of which is the total  
16 number of vehicle miles of the company everywhere. The words "vehicle miles" shall  
17 mean miles traveled by vehicles owned or operated by the company hauling property  
18 for a charge or traveling on a scheduled route.

19 (p) All ~~business~~-apportionable income of a motor carrier of passengers shall be  
20 apportioned by multiplying the income by a fraction, the numerator of which is the  
21 number of vehicle miles in this State and the denominator of which is the total  
22 number of vehicle miles of the company everywhere. The words "vehicle miles" shall  
23 mean miles traveled by vehicles owned or operated by the company carrying  
24 passengers for a fare or traveling on a scheduled route.

25 (q) All ~~business~~-apportionable income of a telegraph company shall be  
26 apportioned by multiplying the income by a fraction, the numerator of which is the  
27 property factor plus the payroll factor plus the sales factor and the denominator of  
28 which is three.

29 The property factor shall be as defined in subsection (j) of this section, the payroll  
30 factor shall be as defined in subsection (k) of this section, and the sales factor shall be  
31 as defined in subsection (l) of this section.

32 (r) All ~~business~~-apportionable income of an excluded corporation and of all  
33 other public utilities shall be apportioned by multiplying the income by the sales  
34 factor as determined under subsection (l) of this section.

35 (s) All ~~business~~-apportionable income of an air or water transportation  
36 corporation shall be apportioned by a fraction, the numerator of which is the  
37 corporation's revenue ton miles in this State and the denominator of which is the  
38 corporation's revenue ton miles everywhere. The term "revenue ton mile" means one  
39 ton of passengers, freight, mail, or other cargo carried one mile. In making this  
40 computation, a passenger is considered to weigh two hundred pounds."

41 **SECTION 5.(i)** G.S. 105-130.8(a)(5) reads as rewritten:

1           "(5) For purposes of this section, any income item deductible in  
2           determining State net income under the provisions of G.S.  
3           105-130.5 and any ~~nonbusiness~~ nonapportionable income not  
4           allocable to this State under the provisions of G.S. 105-130.4 shall  
5           be considered as income not taxable under this Part. The amount of  
6           the income item considered income not taxable under this Part is  
7           determined after subtracting related expenses for which a deduction  
8           was allowed under this Part."

9           **SECTION 5.(j)** G.S. 105-122(c)(1) reads as rewritten:

10          "(c) (1) After ascertaining and determining the amount of its capital stock,  
11               surplus and undivided profits, as provided herein, every corporation  
12               permitted to allocate and apportion its net income for income tax  
13               purposes under the provisions of Article 4 of this Chapter shall  
14               apportion ~~said~~ its capital stock, surplus and undivided profits to this  
15               State through use of the fraction computed for apportionment of its  
16               ~~business~~ apportionable income under ~~said~~ that Article. A  
17               corporation that is subject to franchise tax under this Article but is  
18               not subject to income tax under Article 4 of this Chapter must  
19               apportion its capital stock, surplus, and undivided profits to this  
20               State by using the apportionment formula that would apply to the  
21               corporation if it were subject to Article 4.

22               ~~Provided, that although~~ Notwithstanding the foregoing, if a  
23               corporation is authorized by the Tax Review Board to apportion its  
24               ~~business~~ apportionable income by use of an alternative formula or  
25               method, the corporation may not use ~~such~~ this alternative formula or  
26               method for apportioning its capital stock, surplus and undivided  
27               profits unless specifically authorized to do so by order of the Tax  
28               Review Board.

29               ~~Provided, further, that a~~ A corporation ~~which~~ that is required to  
30               pay an income tax to this State on its entire net income shall  
31               apportion its entire capital stock, surplus and undivided profits to  
32               this State."

33          **SECTION 6.** G.S. 105-129.42(a)(3) reads as rewritten:

34          "(a) Definitions. – The following definitions apply in this section:

35               ...

36               (3) Qualified residential unit. ~~Residential Unit~~. – A housing unit that  
37               meets the requirements of section 42 of the Code."

38          **SECTION 7.** G.S. 105-129.42(g) reads as rewritten:

39          "(g) Return and Payment. – A taxpayer may claim the credit allowed by this  
40          section on a return filed for the taxable year in which the taxpayer receives a  
41          carryover allocation of a federal low-income housing credit. The return must state the

1 name and location of the qualified low-income housing development for which the  
2 credit is claimed.

3 If a taxpayer chooses the loan method for receiving the credit allowed under this  
4 section, the Secretary must transfer to the Housing Finance Agency the amount of  
5 credit allowed the taxpayer. The Agency must loan the taxpayer the amount of the  
6 credit on terms consistent with the Qualified Allocation Plan. The Housing Finance  
7 Agency is not required to make a loan to a qualified North Carolina low-income  
8 housing development until the Secretary transfers the credit amount to the Agency.

9 If the taxpayer chooses the direct tax refund method for receiving the credit  
10 allowed under this section, the Secretary must transfer to the Housing Finance  
11 Agency the refundable excess of the credit allowed the taxpayer. The Agency holds  
12 the refund due the taxpayer in escrow, with no interest accruing to the taxpayer  
13 during the escrow period. The Agency must release the refund to the taxpayer upon  
14 the occurrence of the earlier of the following:

- 15 (1) The Agency determines that the taxpayer has complied with the  
16 Qualified Allocation Plan and has completed at least fifty percent  
17 (50%) of the activities included in the development's eligible basis.
- 18 (2) Within 30 days after the date the development is placed in service  
19 date."

20 **SECTION 8.** G.S. 105-129.42(i) reads as rewritten:

21 (i) **Liability From Forfeiture.** – A taxpayer that forfeits all or part of the credit  
22 allowed under this section is liable for all past taxes avoided and any refund claimed  
23 as a result of the credit plus interest at the rate established under G.S. 105-241.1(i).  
24 The interest ~~rate~~ is computed from the date the Secretary transferred the credit  
25 amount to the Housing Finance Agency. The past taxes, refund, and interest are due  
26 30 days after the date the credit is forfeited. A taxpayer that fails to pay the taxes,  
27 refund, and interest by the due date is subject to the penalties provided in G.S.  
28 105-236."

29 **SECTION 9.** G.S. 105-299 reads as rewritten:

30 **"§ 105-299. (Effective for taxes imposed for taxable years beginning on or after**  
31 **July 1, 2003) Employment of experts.**

32 The board of county commissioners may employ appraisal firms, mapping firms  
33 or other persons or firms having expertise in one or more of the duties of the assessor  
34 to assist the assessor in the performance of these duties. The county may also assign  
35 to county agencies, or contract with State or federal ~~agencies, for~~ agencies for, any  
36 duties involved with the approval or auditing of use-value accounts. The county may  
37 make available to these persons any information it has that will facilitate the  
38 performance of a contract entered into pursuant to this section. Persons receiving this  
39 information are subject to the provisions of G.S. 105-289(e) and G.S. 105-259  
40 regarding the use and disclosure of information provided to them by the county. Any  
41 person employed by an appraisal firm whose duties include the appraisal of property

1 for the county must be required to demonstrate that he or she is qualified to carry out  
2 these duties by achieving a passing grade on a comprehensive examination in the  
3 appraisal of property administered by the Department of Revenue. In the employment  
4 of these firms, primary consideration must be given to the firms registered with the  
5 Department of Revenue pursuant to G.S. 105-289(i). A copy of the specifications to  
6 be submitted to potential bidders and a copy of the proposed contract may be sent by  
7 the board to the Department of Revenue for review before the invitation or  
8 acceptance of any bids. Contracts for the employment of these firms or persons are  
9 contracts for personal services and are not subject to the provisions of Article 8,  
10 Chapter 143, of the General Statutes".

11 **SECTION 10.** G.S. 105-358(a) reads as rewritten:

12 "(a) Waiver. – A tax collector may, upon making a record of the reasons  
13 therefor, reduce or waive the ~~ten percent (10%)~~ penalty imposed on giving  
14 a worthless check under G.S. 105-357(b)(2)."

15 **SECTION 11 .** G.S. 20-305.2(a)(7) reads as rewritten:

16 **"§ 20-305.2. Unfair methods of competition.**

17 (a) It is unlawful for any motor vehicle manufacturer, factory branch,  
18 distributor, distributor branch, or subsidiary thereof, to directly or indirectly through  
19 any subsidiary or affiliated entity, own any ownership interest in, operate, or control  
20 any motor vehicle dealership in this State, provided that this section shall not be  
21 construed to prohibit:

22 ...

23 (7) The ownership, operation, or control of a dealership that sells  
24 primarily recreational vehicles as defined in ~~{G.S.}~~ G.S. 20-4.01 by  
25 a manufacturer, factory branch, distributor, or distributor branch, or  
26 subsidiary thereof, if the manufacturer, factory branch, distributor,  
27 or distributor branch, or subsidiary thereof, owned, operated, or  
28 controlled the dealership as of October 1, 2001.

29 (b) This section does not apply to manufacturers or distributors of trailers or  
30 semitrailers that are not recreational vehicles as defined in G.S. 20-4.01."

31 **SECTION 12.** Subchapter I of Chapter 105 of the General Statutes is  
32 amended by adding a new section to read:

33 **"§ 105-1.1. Supremacy of State Constitution.**

34 The State's power of taxation is vested in the General Assembly. Under  
35 Article V, Section 2(1), of the North Carolina Constitution, this power cannot be  
36 surrendered, suspended, or contracted away. In the exercise of this power, the  
37 General Assembly may amend or repeal any provision of this Subchapter in its  
38 discretion. No provision of this Subchapter constitutes a contract that the provision  
39 will remain in effect in future years, and any representation made to the contrary is of  
40 no effect."

41 **SECTION 13.** This act is effective when it becomes law.

## BILL ANALYSIS OF LEGISLATIVE PROPOSAL 7: REVENUE LAWS TECHNICAL CHANGES

BY: MARY SHUPING, RESEARCH DIVISION AND  
MARTHA H. HARRIS, BILL DRAFTING DIVISION

---

**SUMMARY:** *This draft makes technical and clarifying changes to the Revenue and related statutes.*

<b>Sections 1 &amp; 3</b>	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.
<b>Section 2</b>	Re-enacts a session law that did not receive three roll-call readings on adoption of the conference report.
<b>Section 4</b>	Moves the definition of "pass through entity" to the general definitions section and makes appropriate cross-reference changes.
<b>Section 5</b>	Modernizes terminology by changing the word "business" to "apportionable" as it relates to the apportionment of corporate income tax.
<b>Section 6</b>	Correct capitalization.
<b>Section 7</b>	Makes a grammatical change.
<b>Section 8</b>	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.
<b>Section 9</b>	Makes a punctuation change.
<b>Section 10</b>	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, currently G.S. 105-358(a) authorizes waiver of only the 10% penalty.
<b>Section 11</b>	Supplies missing language.
<b>Section 12</b>	Clarifies that the Constitution prohibits the General Assembly from contracting away its taxing power.