



# HOUSE BILL 334: JOBS Grants and Tax Relief .

2021-2022 General Assembly

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|-----------------------|-------------------------------------------|---------------------|--------------|
| <b>Committee:</b>     | Senate Rules and Operations of the Senate | <b>Date:</b>        | May 12, 2021 |
| <b>Introduced by:</b> | Reps. Pickett, Saine                      | <b>Prepared by:</b> | Finance Team |
| <b>Analysis of:</b>   | PCS to Third Edition<br>H334-CSBAxfr-16   |                     |              |

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**OVERVIEW:** *The Senate PCS for House Bill 334 would replace its contents with the JOBS Grant Program and Tax Changes for 2021.*

**CURRENT LAW, BILL ANALYSIS, AND EFFECTIVE DATES:** The Senate PCS for House Bill 334 has four Parts:

**PART I**                    **JOBS Grant Program.**

This Part appropriates \$1 billion of federal funds from the American Rescue Plan Act of 2021 to provide grants to NC businesses that received a COVID-related loan from the State or federal government. The maximum grant amount would be \$18,750 and is determined by multiplying the lesser of the award amount or \$250,000 of the award by 7.5%.

**PART II**                    **Tax Policy Initiatives**

This Part reduces individual and corporate income taxes, simplifies the franchise tax, extends the sunset on the mill rehabilitation tax credits for two years, modifies the gross premiums tax and the tax on cigars, imposes a sales tax on peer-to-peer vehicle rentals, changes the calculation of the late tax payment penalty, and exempts vaccines and cemetery property from the local property tax base.

**PART III**                    **IRC Update and Related Changes**

This Part updates the IRC reference date from May 1, 2020 to April 1, 2021. This change permanently reduces the medical expense deduction threshold from 10% of AGI to 7.5%. This Part also enacts a SALT cap election for pass-through entities and provides a separate net operating loss calculation for individual taxpayers.

**PART IV**                    **Revenue Laws Study Committee Recommendations**

This Part makes technical, clarifying, and administrative changes to the tax law as suggested by the Department of Revenue and recommended by the Revenue Laws Study Committee.

Jeffrey Hudson  
Director



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Legislative Analysis  
Division  
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# House PCS 334

Page 2

## PART I. JOBS GRANT PROGRAM

This Part would create the Job Opportunity and Business Saving Grant Program (the Program) to aid businesses in North Carolina that suffered substantial economic damage from the COVID-19 pandemic. The Department of Commerce (the Department) would be directed to administer the Program. A grant would be awarded to a qualifying business, defined as a business that listed a North Carolina address as its business address on an application for an award amount and was approved for that award amount. An award amount is an amount awarded from the (i) COVID-19 Job Retention Program, (ii) EIDL Advance, (iii) Paycheck Protection Program, (iv) Restaurant Revitalization Fund, or (v) Shuttered Venue Operators Grant Program. An appropriation of \$1 billion from the American Rescue Plan Act of 2021 would be made to fund the Program and the total of all funds granted under the Program may not exceed that amount.

A qualifying business would be eligible to receive a one-time grant for each award amount equal to 7.5% of the award amount or 7.5% of \$250,000, whichever is less. The maximum grant a qualifying business could receive per award amount would be \$18,750. Grant amounts improperly received would be subject to recapture or forfeiture. Grants under the Program would not be taxable at the State level.

Grants from the Program would be awarded as follows:

- **Automatically** (When act becomes law – September 30, 2021) – Once the act becomes law, the Department would be directed to begin issuing grants automatically to qualifying businesses for award amounts approved on or before June 30, 2021 that can be identified through available databases. The Department would be directed to award these automatic grants by September 30, 2021.
- **First Application Period** (October 1, 2021 – November 19, 2021) – Qualifying businesses with award amounts approved on or before June 30, 2021 that did not receive a grant for those award amounts by September 30, 2021 may apply to the Department beginning on October 1, 2021. The Department would be directed to confirm the qualifying business did not previously receive a grant under the Program for the applicable award amount. Grants awarded under the first application period would be paid on a rolling basis. The deadline to apply would be November 19, 2021.
- **Second Application Period** (January 1, 2022 – February 18, 2022) – If funds remain available under the Program after December 31, 2021, the Department would be directed to reopen the Program for a second application period. Any qualifying business with an approved award amount that did not previously receive a grant for the applicable award amount under the Program may apply during the second application period. The Department would be directed to confirm the qualifying business did not previously receive a grant under the Program for the applicable award amount. The deadline to apply would be February 18, 2022. The Department would be directed to wait until the deadline to pay grants under the second application period to ensure adequate funding for all grants awarded during the period. If the Program limit is reached during the second application period, the Department would be directed to reduce each grant awarded under the second application period on a proportionate basis so that the limit is not exceeded.

## PART II. TAX POLICY INITIATIVES

This Part would make the following tax changes:

# House PCS 334

Page 3

- Reduce individual income taxes by reducing the tax rate from 5.25% to 4.99%, conform to the 2022 federal standard deduction amounts, expand eligibility for the child deduction and increase the maximum amount of the child deduction. These changes would become effective for taxable years beginning on or after January 1, 2022.
- Phase-out the corporate income tax rate over five years, beginning with taxable year 2024.
- Simplify and reduce the franchise tax for some taxpayers by eliminating the two alternative franchise tax bases that are calculated on a taxpayer's property investments in the State. This change would be effective for taxable years beginning on or after January 1, 2023 and applicable to the calculation of franchise tax reported on the 2022 and later corporate income tax returns.
- Extend for two years the sunset applicable to mill rehabilitation projects from January 1, 2023 to January 1, 2025, and the sunset applicable to rehabilitated railroad station projects from January 1, 2022 to January 1, 2024. It would also expand the tax credit for rehabilitated railroad station projects by modifying the conditions so that an additional project would qualify.
- Limit the gross premiums tax on surety bonds for bail bonds to the amount remitted by the surety bondsman to the insurer of the bonds, effective for taxable years beginning on or after January 1, 2022.
- Modify the excise tax on cigars to tax online sales the same as in-person sales, and to cap the tax at 30 cents per cigar for all sales, whether in-person or online, effective on or after January 1, 2022.
- Impose the State and local sales tax on short-term vehicle rentals by a peer-to-peer vehicle sharing facilitator, applicable to sales occurring on or after October 1, 2021.
- End the transfer of the alternate highway use tax imposed on short-term vehicle rentals to the General Fund, so that all revenue generated by the alternate highway use tax is credited to the Highway Fund.
- Exempt vaccines and commercial cemetery property from the local property tax base, effective for taxes imposed for taxable years beginning on or after July 1, 2022.

## ***Subpart A, Personal Income Reduction***

Section 2A.1 would reduce the individual income tax rate from 5.25% to 4.99%, effective for taxable years beginning on or after January 1, 2022. North Carolina moved to a flat tax rate system in 2014. Prior to that date, the State used a tiered tax rate system ranging from 6% to 7.75%. The rate in 2014 was 5.8%. The rate has gradually decreased over time to 5.25%, where it stands today.

Section 2A.2 would conform the standard deduction amounts to the 2022 federal standard deduction amounts<sup>1</sup>. This change would be effective for taxable years beginning on or after January 1, 2022. The change would increase the standard deduction amounts by approximately 18.5%:

- Married filing jointly:     \$21,500 to \$25,500
- Married filing separately: \$10,750 to \$12,750
- Head of Household:       \$16,125 to \$19,125
- Single:                     \$10,750 to \$12,750

Section 2A.3 would make two changes to the child deduction amount: it increases the maximum amount of the credit and it expands eligibility for the credit, effective for taxable years beginning on or after January 1, 2022. North Carolina provides a child deduction of up to \$2,500 per child for a taxpayer who

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<sup>1</sup> The federal standard deduction amounts are indexed annually.

# House PCS 334

Page 4

is allowed a federal child tax credit under section 24 of the Code.<sup>2</sup> The deduction amount is based upon the AGI and filing status of the taxpayer. The deduction amount is currently \$0 for taxpayers, married filing jointly, whose AGI is over \$120,000. This section increases the maximum deduction amount to \$3,000 per child and it expands the number of taxpayers who could benefit from the deduction by increasing the AGI limit for married filing jointly to \$140,000. For married filing jointly, the deduction amounts and AGI brackets are as follows:

| <u>AGI</u>                       | <u>Deduction Amount</u> |
|----------------------------------|-------------------------|
| Up to \$40,000                   | \$3,000                 |
| Over \$40,000 – Up to \$60,000   | \$2,500                 |
| Over \$60,000 – Up to \$80,000   | \$2,000                 |
| Over \$80,000 – Up to \$100,000  | \$1,500                 |
| Over \$100,000 – Up to \$120,000 | \$1,000                 |
| Over \$120,000 – Up to \$140,000 | \$500                   |
| Over \$140,000                   | 0                       |

## ***Subpart B, Phase-Out Corporate Income Tax***

Section 2B.1 would phase-out the corporate income tax by reducing the rate by .5% a year, beginning with taxable year 2024, until the rate is \$0 for taxable years beginning on or after January 1, 2028. North Carolina began reducing the corporate income tax rate in 2014 when it decreased the rate from 6.9% to 6%. The rate was last reduced from 3% to 2.5% in 2019.

## ***Subpart C, Franchise Tax Reduction and Simplification***

Section 2C.1 would simplify the franchise tax base calculation and, for some taxpayers reduce the franchise tax amount, by eliminating the two tax bases calculated using property values. The change would become effective for taxable years beginning on or after January 1, 2023 and applicable to the calculation of franchise tax reported on the 2022 and later corporate income tax returns. The elimination of the two property bases will reduce the franchise tax liability of corporations that have significant real and personal property investments in the State.

The franchise tax is imposed on C corporations and S corporations for the privilege of engaging in business in this State. The tax does not apply to a business organized as a limited liability company, unless the LLC elects to be taxed as a corporation for franchise tax purposes, or to a general partnership or sole proprietorship. The rate of tax is \$1.50 per \$1,000, subject to a minimum tax of \$200.<sup>3</sup> The tax rate applies to the highest of three bases. The three bases are:

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<sup>2</sup> To qualify for the federal credit, a child must be under the age of 17 and meet certain other tests, such as dependency and residency requirements.

<sup>3</sup> The maximum franchise tax on a holding company is \$150,000. A S-corporation pays a flat rate of \$200 on the first \$1,000,000 of net worth and \$1.50 for every \$1,000 of net worth over \$1,000,000. The General Assembly reduced the franchise tax on S-corporations for taxable years beginning on or after January 1, 2019.

# House PCS 334

Page 5

- Net worth as computed in accordance with generally accepted accounting principles.<sup>4</sup> *Under the bill, this base would become the franchise tax base for all taxpayers. Most taxpayers use this base and would not see any change in their tax liability.*
- Book value of North Carolina real and tangible personal property, less outstanding debt created to acquire or improve the real property. *The bill would eliminate this base and taxpayers currently using this base would probably see a reduction in their tax liability.*
- 55% of the appraised value of North Carolina real and tangible personal property. *The bill would eliminate this base and taxpayers currently using this base would probably see a reduction in their tax liability.*

## **Subpart D, Mill Rehabilitation Tax Credits**

Section 2D.1 would extend the time to complete eligible mill rehabilitation tax credit projects by approximately two years. To qualify for the general mill rehabilitation tax credit, projects must have received an eligibility certification before January 1, 2015. The eligibility certification expires January 1, 2023. This provision extends the life of the eligibility certification until January 1, 2025.

In 2019, the General Assembly created a specific mill rehabilitation tax credit for an eligible railroad station. This credit sunsets for expenditures occurred on or after January 1, 2022 and for rehabilitation projects not completed and placed in service prior to January 1, 2022. This provision extends the sunset as follows:

- The project must be a designated local landmark as certified by a city on or before September 1, 2020. The date was June 30, 2019. The extension of the date will enable an additional railroad station rehabilitation project to qualify for the mill rehabilitation tax credit.
- The project must be issued a certificate of occupancy on or before December 31, 2023.
- The expenditures must be incurred on or before January 1, 2024, and the project be completed and placed in service prior to July 1, 2024.

## **Subpart E, Limit Gross Premiums Tax on Surety Bonds for Bail Bonds**

Section 2E.1 would limit the gross premium tax base for premiums paid to a surety bondsman to the amount paid by the surety bondsman to the insurer of the bail bonds. The amount paid to a surety bondsman consists of two parts, the amount paid to the insurer of the bail bonds and the amount retained by the surety bondsman for its services. The limitation of the tax base only applies to the transactions related to the insuring of bail bonds, and not to any other line of insurance. The section becomes effective for taxable years beginning on or after January 1, 2022.

The gross premiums tax levied on insurers is imposed on the gross premiums from business done in this State. In determining the amount of gross premiums from business in this State, all gross premiums received in this State unless the statute provides otherwise. This section would limit this calculation in the case of an insurer of bail bonds. The tax rate applied to the taxable gross premiums is 1.9%.

## **Subpart F, Modify Tax on Cigars**

Section 2F.1 would do the following:

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<sup>4</sup> The General Assembly significantly simplified the franchise tax base calculation when it moved from the capital base calculation to the net worth base calculation, effective for franchise tax returns due in 2017.

# House PCS 334

Page 6

- Subject remote sales of cigars to the current rate of excise tax, which is 12.8% of the cost price per cigar. Under current law, cigars are subject to an excise tax at the rate of 12.8% of the cost price<sup>5</sup> of the product, but because the tax is paid by the first person in the State to handle the product, a remote seller is not required to collect the tax.
- Place a cap on the excise tax in the amount of 30¢ per cigar for all purchases of cigars, regardless of whether purchased in-person or online. Effectively, this cap would phase out the tax on amounts paid by a dealer in excess of \$2.35 per cigar. At this price point, the primary impact of the cap would be on premium, or hand-rolled, cigars, which are typically more expensive than machine-made cigars, which are unlikely to hit the cap.
- Modify existing excise tax statutes to more clearly address and distinguish between delivery sales and remote sales of tobacco products. "Delivery sales" are sales of tobacco products subject to the federal PACT Act, which are cigarettes, smokeless tobacco, and vapor products, where the purchase is not made in-person. "Remote sales" are also sales not made in-person but are of tobacco products that are not subject to the PACT Act, like cigars and pipe tobacco. The PACT Act requires age verification, special labeling, detailed reporting, licensing and tax compliance, and registration with ATF and prohibits delivery through U.S. Mail.

All tobacco products, whether sold in-person or online, are also subject to sales tax.<sup>6</sup>

This section would become effective January 1, 2022, and apply to sales or purchases occurring on or after that date.

## ***Subpart G, Provide Tax Parity for Short-Term Vehicle Rentals***

Section 2G.1 would do the following:

- Subject short-term motor vehicle rentals by a peer-to-peer vehicle sharing facilitator to the general rate of State and local sales and use tax, which ranges from 6.75% to 7.50%, depending on the location of the rental. Peer-to-peer vehicle rentals are not currently subject to tax whereas short-term rentals by traditional car rental companies are subject to an 8% highway use tax, plus applicable local taxes ranging from 1.5% to 8%.
- Direct the amount of \$500,000 to be credited annually from the General Fund to the Highway Fund in recognition of the fact that peer-to-peer vehicle rentals exercise the privilege of using the highways of this State.
- Credit to the Highway Fund the proceeds from the alternate highway use tax that is levied on short-term rentals and vehicle subscriptions. Currently, only the first \$10 million of these proceeds goes to the Highway Fund, and the remainder goes to the General Fund.

Peer-to-peer vehicle sharing is an alternative business model to traditional car rental companies. Under this model, a retailer facilitates the short-term use of motor vehicles between vehicle owners and users. Owners register and list their vehicles on the facilitator's website for use by others for a fee. It is similar in concept to Airbnb, which facilitates accommodation rentals between homeowners and travelers.

A person who purchases a vehicle must pay a 3% highway use tax. When a traditional car rental company purchases vehicles for its fleet, it has an option to pay either the 3% highway use tax or, if the vehicles

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<sup>5</sup> Defined as the price a person liable for the tax paid for the products, before any discount, rebate, or allowance, or the tax imposed on the product. G.S. 105-113.4(2).

<sup>6</sup> A retailer is only required to collect sales tax if the retailer has economic nexus with this State, which means they have gross sales to NC residents in excess of \$100,000 or at least 200 separate transactions.

# House PCS 334

Page 7

will be used only for lease or rental, to collect an 8% tax on the gross receipts derived from the leases or rentals. This election is referred to as the "alternate highway use tax." The highway use tax and the alternate highway use tax are triggered when a person applies for a certificate of title upon the purchase of a car. Since peer-to-peer facilitators do not own the cars listed on their website, neither tax is triggered.

This provision would become effective October 1, 2021, and apply to sales occurring on or after that date.

## ***Subpart H, Property Tax Exemptions***

Section 2H.1 would exempt burial property owned and held for purposes of sale or rental, or sale of burial rights therein, from property taxation, effective for taxes imposed for taxable years beginning on or after July 1, 2022. This would effectively exempt all burial property from property taxation. The amount of property taxes exempted for any burial property owned or held for the purposes of sale or rental, or sale of burial rights therein, would become a lien on the property and carried forward as deferred taxes. The deferred taxes for the preceding five years would be owed if the property were ever transferred for a purpose other than burial purposes. This section also expands the real property that may be exempted from taxation to include buildings, structures, improvements, or permanent fixtures on the burial property. To receive the exemption, a taxpayer must file a single application with the county assessor in which the property is situated.

Section 2H.2 would exempt vaccines from the local property tax base, effective for taxes imposed for taxable years beginning on or after July 1, 2022. Vaccines held by private medical facilities and doctors' offices are taxable as business personal property. The value of the property is usually assigned based on an estimate of the amount routinely held by that facility, not on the amount held on a certain day or the amount held throughout the year. Vaccines held by pharmacies and other retailers are exempt from property tax b/c they are inventory and inventory of retailers is exempt from tax. Vaccines held by nonprofit medical facilities are exempt from property tax b/c real and personal property of the nonprofit exempt from tax.

## ***Subpart I, Graduate Late Payment Penalties***

Section 2I.1 would replace the flat penalty amount assessed for failure to pay a tax when due to a graduated amount. The current flat penalty amount is equal to 10% of the tax. This section would reduce the penalty amount to 2% of the tax for the first month, increased 2% for each succeeding month or fraction thereof, not to exceed 10%. This change becomes effective January 1, 2022 and applies to penalties assessed on or after that date.

## **PART III. IRC UPDATE AND OTHER INCOME TAX CHANGES**

This Part would make the following tax law changes:

- Update the Code reference date from May 1, 2020 to April 1, 2021. This change will conform the State's medical expense deduction threshold amount to the federal amount. By conforming to this change, the State will permanently reduce the threshold amount from 10% of AGI to 7.5%.
- Allow pass-through entities to elect to pay the State income taxes at the entity level, which is not subject to the federal state and local tax cap of \$10,000. This change is effective for taxable years beginning on or after January 1, 2021.
- Provide a separate calculation at the State level for determining the net operating loss deduction that more closely aligns with NC taxable income. This change is effective for taxable years beginning on or after January 1, 2021.

## ***Subpart A, IRC Update***

# House PCS 334

Page 8

Section 3.1(a) updates the reference to the Internal Revenue Code used in defining and determining certain State tax provisions from May 1, 2020 to April 1, 2021. North Carolina's tax law tracks many provisions of the federal Internal Revenue Code by reference to the Code.<sup>7</sup> The General Assembly determines each year whether to update its reference to the Code.<sup>8</sup> Updating the reference makes recent amendments to the Code applicable to the State to the extent that State law previously tracked federal law. The General Assembly's decision whether to conform to federal changes is based on the fiscal, practical, and policy implications of the federal changes.

The update of the Code reference will conform the State's medical expense deduction to the permanent lowering of the threshold for taking the federal medical expense deduction from 10% of AGI to 7.5%. This deduction allows a taxpayer to deduct unreimbursed medical expenses that exceed 7.5% of the taxpayer's AGI. The "floor" for the medical expense deductions has fluctuated during recent years between 7.5% and 10%. The floor was scheduled to return to 10% for the 2021 taxable year. The Consolidated Appropriations Act, 2021, enacted on December 27, 2020, made the 7.5% floor permanent.

Section 3.1(b) and (c) would decouple from the following provisions that were extended by Congress or enacted by Congress under either the Consolidated Appropriations Act, 2021, or the American Rescue Plan Act of 2021:

- Income exclusion for forgiveness of debt on a primary residence. The General Assembly has decoupled from this provision every year since 2014.
- Income exclusion for employer payments of student loans. The General Assembly decoupled for tax year 2020.
- Deduction for mortgage insurance premiums treated as interest for taxpayers who itemize. The General Assembly has decoupled from this provision every year since 2014.
- 100% deduction for business related expenses for food and beverages provided by a restaurant for 2021 and 2022. NC would continue to allow a 50% deduction for these expenses.
- Income exclusion for the discharge of a student loan. The federal provision is limited to student loans discharged in 2021-2025.
- Income exclusion for certain unemployment compensation. The federal provision excludes the first \$10,500 of 2020 unemployment benefits, limited to households with AGI of less than \$150,000.

Section 3.1(c) and (d) would clarify that the add-back for expenses deducted under the Code applies to the extent the expense is allocable to income that is either wholly excluded from gross income or wholly exempt from tax. The current provision is limited to a covered loan under the CARES act. The clarification would apply to all similarly treated federal programs, for example: Emergency EIDL grants

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<sup>7</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>8</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."

# House PCS 334

Page 9

and targeted EIDL advances, loans under the Debt Relief Program, grants for Shuttered Venue Operators, and Restaurant Revitalization grants.

All of the changes made by this section become effective when they become law.

## ***Subpart B, SALT Cap***

This Subpart would allow pass-through entities to elect to pay the State income taxes at the entity level, which is not subject to the federal state and local tax cap of \$10,000, effective for taxable years beginning on or after January 1, 2021. The 2017 Tax Cuts and Jobs Act (TCJA) imposed a \$10,000 cap on the amount of SALT individual taxpayers can deduct on their federal returns. Typically, pass-through entities such as partnerships and S corporations allocate business income to the owners' individual income tax returns, which is subject to the SALT cap. In proposed regulations, Notice 2020-75, the Internal Revenue Service and the Department of the Treasury signaled their approval of a workaround that allows the pass-through entity to pay the state income taxes at the entity level, which is not subject to the SALT cap. This workaround allows the owners to avoid the SALT cap on the taxes paid by the entity. The workaround only works for shareholders and members of S corporations, partnerships, and LLCs treated as partnerships for federal income tax purposes.

Section 3B.1 would allow an S corporation to elect to be taxed at the State level. The election is made on its timely filed annual return, is irrevocable, and covers that taxable year. The election must be made each year. Tax credits and any carryforwards or installments of those tax credits must be taken by the taxpayer that filed the return for the year the initial tax credit was taken. The full amount of tax payable as shown on the return must be paid within the time allowed for filing the return. If the taxed S corporation does not pay the amount shown as due, the Secretary must issue a notice of collection for the tax debt to the taxed S Corporation. If the tax debt is not paid within 60 days of the date the notice of collection is mailed to the taxed S corporation, Secretary must send the shareholders a notice of proposed assessment.

Section 3B.2 would allow a partnership to elect to be taxed at the State level. The provisions governing this election are the same as the provisions for a taxed S corporation. The election cannot be made by a publicly traded partnership or by a partnership that has at any time during its taxable year a partner who is not an individual, an estate, a trust, or an organization described in section 1361(c)(6) of the Code.

Section 3B.3 would allow an individual income taxpayer who is a shareholder of a taxed S corporation or a partner of a taxed partnership to make the following adjustments to the taxpayer's adjusted gross income:

- A deduction of the amount of the taxpayer's pro rata share or distributive share of income from the taxed pass-through entity to the extent it was included in the taxed pass-through entity's NC tax income and the taxpayers AGI.
- An addition of the amount of the taxpayer's pro rata share or distributive share of loss from the taxed pass-through entity to the extent it was included in the taxed pass-through entity's NC taxable income and the taxpayer's AGI.

Section 3B.4 would not allow a shareholder or partner of a taxed pass-through entity, or fiduciaries and beneficiaries of estates and trusts who are shareholders or partners of a taxed pass-through entity, a credit for taxed paid by the taxed pass-through entity to another state or country. The taxed pass-through entity is allowed the credit. And Section 3B.5 would provide that a taxed pass-through entity must pay estimated taxes.

# House PCS 334

Page 10

## ***Subpart C, Separate State NOL Calculation for Individual Taxpayers***

Section 3C.1 would create a separate North Carolina NOL calculation, effective for taxable years beginning on or after January 1, 2021. A separate State NOL calculation would more closely align to the calculation of North Carolina taxable income, adjustments for differences between federal and State law, and business activities taking place in multiple states.

North Carolina has a corporate NOL calculation that is separate from the federal calculation, but it does not have a separate NOL calculation for individual income tax. The federal loss amount is the taxpayer's State loss amount. This calculation benefits some taxpayers but hurts others.

Section 3C.1(a) would require a taxpayer to add-back the amount allowed as a NOL under the Code, and to deduct the State NOL amount. Section 3C.1(b) would provide the new rules for calculating the State NOL deduction amount. It provides that any remaining losses from years prior to January 1, 2021 may be carried forward, but the old loss amounts would not be calculated using the new rules. This transition rule is consistent with how the State treated prior year losses when it modified the corporate NOL calculation in 2015.

## **PART IV. REVENUE LAWS TECHNICAL, CLARIFYING, AND ADMINISTRATIVE CHANGES**

This Part would make the following changes to various tax laws recommended by the Revenue Laws Study Committee and the Department of Revenue:

| <b><i>SUBPART A: PERSONAL INCOME TAX CHANGES</i></b> |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |                           |
|------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------|
| 4A.1                                                 | <p>This section does two things:</p> <ul style="list-style-type: none"><li>• Makes technical correction by renumbering a subdivision.</li><li>• Extends the sunset of the deduction from federal AGI of any amounts the taxpayer received from the State as an Extra Credit grant amount from January 1, 2021 to January 1, 2022. The grant program was extended into the 2021 taxable year.</li></ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     | When the act becomes law. |
| 4A.2                                                 | <p>Corrects an unintended consequence when NC decoupled from a provision in the CARES Act by allowing a taxpayer to fully deduct the applicable amount of business interest expense over time. NC conformed to the federal TCJA in 2017. Part of the TCJA limited the interest expense deduction under section 163(j) of the Code for taxpayers with \$25M or more in receipts per year to 30% of the taxpayer's AGI. Under the CARES Act, Congress increased the interest expense limitation from 30% to 50% for the 2019 and 2020 taxable years. NC decoupled from this change and remains at 30%. To decouple from the federal provision, State law requires a taxpayer to addback the difference. This section does two things:</p> <ul style="list-style-type: none"><li>• It provides that the add-back is not required to the extent the amount was added back under another provision of State law to avoid a double add-back.</li><li>• It provides a taxpayer may deduct over a five-year period the amount of interest expense allowed under federal law that exceeds</li></ul> | When the act becomes law. |

# House PCS 334

Page 11

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|------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------|
|                                                | the State's 30% limit. Without this change, the taxpayer would be permanently disallowed the full amount of the deduction.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |                            |
| 4A.3                                           | Makes technical correction by deleting a reference to a repealed statute.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              | When the act becomes law.  |
| 4A.4                                           | Increases the time allowed for an employer to file an informational return reporting wages (Form NC-3) when the employer terminates its business. Under current law, an employer who terminates its business or permanently ceases paying wages must file an informational return within 30 days of the last payment of wages. Informational returns would now be due the month after the end of the calendar quarter when the employer terminates its business (but no later than January 31 of the succeeding year). This section also removes the duty to file when an employer permanently ceases paying wages. This section matches federal filing requirements for IRS Forms W-2, W-3, and 1099. | When the act becomes law.  |
| 4A.5                                           | Explicitly states the Secretary of Revenue can assess a withholding agent based on an estimate of the tax due when the withholding agent fails to file a return or files a grossly incorrect, false, or fraudulent return. New G.S. 105-163.8(c) mirrors existing G.S. 105-164.32 which has the same language for sales and use tax.                                                                                                                                                                                                                                                                                                                                                                   | When the act becomes law.  |
| 4A.6                                           | Clarifies that a request for a tax refund is due 6 months after the contingent event concludes. Under current law, refund claims delayed due to litigation or a state tax audit are due 6 months after the litigation or audit concludes. This section clarifies that the same period applies to other contingent events that prevent the taxpayer from filing an accurate and definite request for a refund.                                                                                                                                                                                                                                                                                          | When the act becomes law.  |
| 4A.7                                           | Authorizes the Secretary of Revenue to allow the use of truncated taxpayer identification numbers (TTIN) on tax returns and other documents. TTIN helps prevent identity theft by using only the last 4 digits of a Social Security number (e.g., XXX-XX-9999). Under current law, the General Assembly must authorize the use of a TTIN on each type of tax form. The Secretary wants to avoid repeated law changes as IRS forms, payroll forms, and tax return forms change. For example, for the 2020 tax year, the IRS allows payroll providers to submit IRS Form W-2 with TTIN to prevent identity theft. The NC Department of Revenue lacks the authority to conform to the use of the TTIN.    | When the act becomes law.  |
| 4A.8                                           | S.L. 2021-16 provided for the nonaccrual of interest on individual income tax returns due on or before April 15, 2021, from April 15 through May 17, 2021. This section clarifies that for the purposes of the nonaccrual of interest, an individual income tax return includes partnership and estate and trust tax returns.                                                                                                                                                                                                                                                                                                                                                                          |                            |
| <b>SUBPART B: CORPORATE INCOME TAX CHANGES</b> |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |                            |
| 4B.1                                           | Corrects an omission from 2015 when the General Assembly made the policy decision to tax banks in the same manner as other corporations. As part of that legislation, the General Assembly repealed the privilege license                                                                                                                                                                                                                                                                                                                                                                                                                                                                              | Effective retroactively to |

# House PCS 334

Page 12

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|                                             | tax on banks <sup>9</sup> but it failed to make a corresponding change to the exemption for banks from the privilege license tax on installment paper dealers. This section makes that change.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 | the 2016 taxable year.                                                                        |
| 4B.2                                        | Prevents a double denial of interest expenses. Substantially the same explanation as Section 4A.2, while considering the limitation that may be required under G.S. 105-130.7B.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                | When the act becomes law.                                                                     |
| 4B.3                                        | Prevents a double denial of nondeductible interest expenses. Both State and federal tax law limit the deduction amount allowed for net business interest expenses. Therefore, it is possible that a partial limitation has been imposed on the intercompany interest under section 163(j) of the Code, and if that is the case, that deduction needs to be recognized by G.S. 105-130.7B. Otherwise, the taxpayer may have to add back more interest than it actually incurred in total.                                                                                                                                                                                                                                                                                       | Effective retroactively to taxable years beginning on or after January 1, 2018. <sup>10</sup> |
| 4B.4                                        | Clarifies that, for taxable years beginning on or after January 1, 2015, the limitations of Code sections 381 and 382 apply to all losses from mergers and acquisitions regardless of the date of the merger or acquisition. The clarification takes the position most favorable to the taxpayer. It also provides parity among taxpayers and eases the administration of the carry-forward for both the taxpayer and the Department.                                                                                                                                                                                                                                                                                                                                          | When the act becomes law.                                                                     |
| 4B.5                                        | This section requires a taxpayer to provide financial or tax documentation necessary for the Department to make the appropriate adjustments and determinations under G.S. 105-130.5A. G.S. 105-130.5A requires the Secretary to adjust net income or require a combined report when the Secretary has reason to believe a corporation fails to accurately report its State net income using intercompany transactions. This change provides that if the Secretary requests information or documentation needed under G.S. 105-130.5A, and the information is not timely provided, the Secretary may propose any allowable adjustment, including the filing of a combined return. All tax information is protected by the tax secrecy provisions of G.S. 105-259. <sup>11</sup> | When the act becomes law.                                                                     |
| <b>SUBPART C: SALES AND USE TAX CHANGES</b> |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |                                                                                               |
| 4C.1                                        | Expands the sales and use tax exemptions for certain purchases made by qualifying farmers and conditional farmers to include fowl. Currently, livestock, baby chicks, and poults are exempt from sales and use tax when purchased by a qualifying farmer or conditional farmer and used primarily in farming operations. This section would expand the types of animals that are exempt from sales and use taxes to include, among other things, adult chickens and turkeys.                                                                                                                                                                                                                                                                                                   | Effective retroactively to July 1, 2020 and applies to purchases made on or after that date.  |
| 4C.2                                        | Removes obsolete language. The statutes referenced G.S. 105-259(b)(5b) have been repealed and the subdivision is no longer needed.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             | When the act becomes law.                                                                     |

<sup>9</sup> The corporate income tax change resulted in an increased tax burden on banks. The repeal of the privilege tax on banks helped to offset this tax burden.

<sup>10</sup> The taxable year the federal law changes under section 163(j) became effective.

<sup>11</sup> Violation of the tax secrecy provisions is a Class 1 misdemeanor and dismissal of the employee from public employment.

| <b>SUBPART D: EXCISE TAX HEARING CHANGES</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |                                                                                                                                                    |
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| <p>This Part represents a comprehensive restructuring of the license revocation and hearing procedures across all excise tax schedules to streamline and make consistent these procedures. The affected schedules are tobacco products, motor carriers, motor fuels, and alternative fuels.</p> <p>Below is a summary of the current law. This Part maintains the two distinct methods for revocation – summary and non-summary – but provides more specificity with respect to the process and makes them more consistent across all excise tax schedules. <u>Please see the tables at the end of this summary that show how the procedures proposed by this Part differ from the current law.</u></p> <p><b><u>License Revocation for Tobacco, Motor Fuels, and Alternative Fuels Licensees.</u></b></p> <p>– The license revocation and hearing procedures under the tobacco product, motor fuel, and alternative fuel schedules share similar features. Specifically, the Secretary of Revenue may revoke a license in two ways:</p> <p><b><u>Summary Revocation.</u></b> – The Secretary may summarily revoke a license, which means that the license is revoked <u>prior</u> to a hearing, if the Secretary discovers that a licensee is incurring tax liability after failing to pay a tax when due. The Secretary must hold a hearing within 10 days of the revocation after sending notice to the revoked licensee. Summary revocation is not often used by the Department and is reserved for extraordinary circumstances.</p> <p><b><u>Non-Summary Revocation.</u></b> – The more common method for revoking a license is after holding a hearing, regardless of whether the licensee has requested one. The Secretary must provide the licensee with at least 10 days' written notice of the hearing. If the licensee fails to attend the hearing, the license revocation is effective 15 days after the noticed hearing. The statutes are silent as to when the Secretary must issue a final decision and the content of that decision if the licensee attends the hearing. The Department asserts that holding a hearing even if a licensee has not requested one is an inefficient use of its resources because it requires them to fully prepare and conduct a hearing whether or not the licensee has expressed their intention to maintain the license or attend the hearing.</p> <p><b><u>License Revocation for Motor Carriers.</u></b> – Not only is the revocation and hearings procedure for motor carriers different than the other excise tax schedules, it is not set out in statute. G.S. 105-449.57 permits the Secretary to enter into cooperative agreements with other jurisdictions regarding the administration of the motor carrier tax. To the extent our statutes are silent, the Department follows the IFTA Rules for revocation. These rules differ from the other revocation procedures in the three primary ways: (1) a taxpayer can only request a hearing after revocation; (2) a licensee must request a hearing within 30 days; and (3) 20 days' hearing notice is required. Unlike the procedures for other excise tax schedules, the Department does not perform summary revocations or provide a hearing before revocation. Instead, the Department notifies the motor carrier taxpayer of the intent to revoke the license and then revokes it if the taxpayer does not come into compliance. There is an opportunity for a hearing after the revocation.</p> | <p>Effective January 1, 2022 and applies to summary revocations and non-summary revocations initiated by the Department on or after that date.</p> |
| <b>SUBPART E: OTHER EXCISE TAX CHANGES</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |                                                                                                                                                    |

# House PCS 334

Page 14

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| 4E.1 – 4E.4 | Recodifies various statutes to a more appropriate place and makes technical and conforming changes.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        | When the act becomes law.                                                          |
| 4E.5        | Clarifies that non-licensed distributors must file a use tax report when acquiring non-tax-paid cigarettes.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                | When the act becomes law.                                                          |
| 4E.6        | Removes unnecessary language. "Vapor products" are included in the definition of "tobacco products" and therefore makes the language being removed redundant and unnecessary.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              | When the act becomes law.                                                          |
| 4E.7        | <p>Provides that non-licensed wholesale dealers and non-licensed retail dealers must file a use tax report on non-tax-paid tobacco products, other than cigarettes, and pay the tax due within 96 hours after acquisition.</p> <p>This mirrors the requirements for use tax payments and reports for cigarettes and provides consistency with regard to use tax payments and reports for all tobacco products. Currently, the use tax reporting and payment requirements for cigarettes and other tobacco products are different.</p>                                                                                                                                                                                                                                                                                                                      | When the act becomes law.                                                          |
| 4E.8        | <p>Codifies the current practice of the Department and industry and makes a clarifying change. Generally, the wholesaler or importer who first handles the alcoholic beverage in the State is required to pay the excise tax on the product. However, the Department, by policy, authorizes an exception to this rule. The Department authorizes an ABC permitted wholesaler to remit the excise tax when a brewery or winery transfers their product to the wholesaler for distribution and the wholesaler agrees to pay the excise tax on the product. This section would codify this practice.</p> <p>This section also moves language pertaining to wine shipper permittees to a more appropriate place.</p>                                                                                                                                           | When the act becomes law.                                                          |
| 4E.9        | Requires distilleries to be bonded. Generally, any ABC permittee that can incur excise tax liability must be bonded. Distilleries are authorized to incur excise tax liability but are not currently required to be bonded. This section would require distilleries to be bonded and treat them similarly to other ABC permittees that are authorized to incur excise tax liability.                                                                                                                                                                                                                                                                                                                                                                                                                                                                       | When the act becomes law.                                                          |
| 4E.10       | <p>Changes the penalties for engaging in business as a distributor, wholesale dealer, or retail dealer without first obtaining the appropriate license. Currently, the maximum penalty is \$6.25 for failing to obtain a distributor license or wholesale dealer license, and \$5.00 for failing to obtain a retail dealer license. The Department has had some issues with compliance due to the current penalty not providing an effective deterrent.</p> <p>This section would increase the potential penalty to \$1,000 for failing to obtain the respective license, which is on par with the penalties for failing to obtain various motor fuel licenses. To assess the penalty, the Department must provide written notification to the taxpayer of their noncompliance, and the taxpayer must fail to comply after receiving the notification.</p> | Effective January 1, 2022 and applies to penalties assessed on or after that date. |
| 4E.11       | Codifies the current authority to assess a failure to pay penalty on motor carriers that fail to pay tax when due under the International Fuel Tax                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         | When the act becomes law.                                                          |

# House PCS 334

Page 15

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|       | <p>Agreement (IFTA), provides exceptions to the penalty, and authorizes the Department to waive failure to file and failure to pay penalties on motor carriers. IFTA is an agreement between member taxing jurisdictions to assist each other in the collection and administration of taxes paid by interstate motor carriers on their use of motor fuel. North Carolina has been a member of IFTA since 1992.</p> <p>This section codifies the current practice of the Department when assessing failure to pay penalties for motor carriers authorized under IFTA as well as exceptions to the penalty provided for under North Carolina law. The penalty is \$50.00 or 10% of the tax due, whichever is greater.</p> <p>This section also provides authority for the Department to waive any failure to file or failure to pay penalty assessed against a motor carrier.</p>                                                                                                                                                                                                                          |                                                                                    |
| 4E.12 | <p>Creates a definition of "fuel grade ethanol" and adjusts the definition of "gasohol" to continue to capture gasohol in the same manner as it is currently.</p> <p>Currently, there is no definition of "fuel grade ethanol" but it is considered a taxable motor fuel. Without a proper definition of fuel grade ethanol, the Department has had difficulty assessing liability on taxpayers. The Department requested this change to aid in compliance by providing certainty as to what fuel grade ethanol is.</p> <p>The definition of "gasohol" refers to fuel grade ethanol, but currently captures more than what the new definition of fuel grade ethanol would cover. Therefore, the Department requested an update to the definition of gasohol to continue to capture gasohol as it is captured currently.</p>                                                                                                                                                                                                                                                                              | Effective January 1, 2022.                                                         |
| 4E.13 | <p>Aligns the shipping document requirements when transporting motor fuel by railroad tank cars, transport trucks, and tank wagons. This will reduce confusion and aid in compliance when motor fuel is diverted to a state other than the state listed on the shipping document.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    | Effective January 1, 2022.                                                         |
| 4E.14 | <p>Changes the penalty for failing to properly mark certain dyed, nontaxable, motor fuel storage facilities. Dyed motor fuel is not for use on the highway and therefore is not taxable. A person who is a retailer of dyed motor fuel or anyone who stores both dyed and undyed motor fuel must properly mark the storage tanks of dyed motor fuel or be assessed a penalty. Currently the penalty is equal to the motor fuel rate multiplied by the inventory held in the storage tank or, if the inventory cannot be determined, the penalty is calculated on the capacity of the storage tank.</p> <p>This section would remove the requirement that the Department determine inventory or capacity and make the penalty a flat \$250.00 per offense. Each inspection resulting in non-compliance would be a separate offense.</p> <p>The Department requested this change to ease administrative burden as it is often difficult to ascertain the tank size and amount of fuel in the tank. The Department estimates this change will decrease the average penalty assessed under this section.</p> | Effective January 1, 2022 and applies to penalties assessed on or after that date. |

# House PCS 334

Page 16

| <b><i>SUBPART F: LOCAL GOVERNMENT CHANGES</i></b> |                                                                                                                                                                                                                                                                                                                                                                          |                                           |
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| 4F.1                                              | Makes an update to reflect the proper statutory reference. Local planning and development regulation statutes in Chapters 153A and 160A were recodified to Chapter 160D. This section updates the statutory reference as historic landmarks are now designated as such under a local ordinance adopted pursuant to G.S. 160D-945 (which was previously G.S. 160A-400.5). | Effective retroactively to June 19, 2020. |